SMALL BUSINESS EXPENSING: INCREASING INCENTIVES FOR SMALL COMPANIES TO GROW AND INVEST IN THEIR BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX, FINANCE, & EXPORTS

OF THE

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HOUSE OF REPRESENTATIVES

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HEARING ON SMALL BUSINESS EXPENSING: INCREASING INCENTIVES FOR SMALL COMPANIES TO GROW AND INVEST IN THEIR BUSINESSES

Thursday, April 3, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TAX, FINANCE, AND EXPORTS,
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C.

The Subcommittee met, pursuant to call, at 10:07 a.m. in Room 2360, Rayburn House Office Building, Hon. Pat Toomey [chairman of the Subcommittee] presiding.

Present: Representatives Toomey, Franks, Gerlach, Beauprez, and Millender-McDonald.

Chairman TOOMEY. Good morning, everyone. Thank you all for being here today.

This morning we are going to examine potential changes to Section 179 of the Internal Revenue Code, the provision of the Tax Code that limits the amount of money that a small business may directly expense in a given year versus that which must be depreciated with respect to assets that are purchased by a business.

The reason we need to examine this issue is because it has a big impact on small businesses. Small businesses, as we all know, are a big part of the key to a strong economic recovery and getting American workers back to work. According to the Small Business Administration, three out of every four new jobs in America are created by small businesses. In total, they represent more than 99 percent of all employers and employ 51 percent of private sector workers.

As the economy continues to struggle in response to the recession that began in March 2001, we are witnessing a great strength of small business and a great resilience as they continue to drive our economy. That having been said, our small businesses are still struggling. We need in Congress to create an environment where America's small businesses and entrepreneurs can thrive and can succeed and can expand and grow, and that is what this should be about.

Let me just touch briefly on what Section 179 of the Tax Code currently does. Under the existing law, in lieu of depreciation a small business taxpayer with a sufficiently small amount of annual investments in capital purchases may elect to deduct up to $25,000 of the cost of qualifying property placed in service for a given taxable year. In general, qualifying property is defined as depreciable, tangible, personal property that is purchased for the use in the active conduct of a trade or business.

Now, the $25,000 amount which can be expensed is reduced by the amount by which the cost of qualifying property placed in service by that company for the full year exceeds $200,000, which is an interesting mechanism that is in place. What basically happens is there is an incentive to purchase $25,000 worth of assets. The Code is essentially neutral for the next $175,000 worth of assets that one might purchase.

Then there is actually a disincentive for the next $25,000 which one might purchase because, if my understanding is correct, that incremental amount over $200,000 actually then causes you to lose the opportunity to expense the first $25,000 that you thought you were able to expense.

I think what we ought to discuss today in part is how could we go about increasing the incentive part of this equation and perhaps diminishing the disincentive part of this equation so that we can encourage more businesses to put more tangible property to work, to make more investments.

Now I will share my bias with you. In a perfect world, I would like to see the end of depreciation schedules altogether and go to a tax regime in which we have full expensing across the board. It would rid ourselves of one of the most complicated and onerous parts of the entire Tax Code. I realize we are not going to get there overnight, and I think an excellent place to start and move somewhat in that direction is to increase the direct expensing limits in the Section 179, which brings me to the President's plan for economic stimulus.

The President has proposed that we increase the amount of tangible property that can be expensed according to Section 179 from $25,000 to $75,000. I think that is an integral part of the President's economic stimulus plan. Increasing this limit works in conjunction with other aspects of the President's plan, such as accelerating the individual marginal tax rate reductions and reducing the taxation of capital income in the form of dividend income. I think all of these are very constructive measures, but we are here primarily to focus on the Section 179.

Now, the other part of the President's proposal with regard to Section 179 is that he would also raise the threshold limit above which one would no longer be able to take this expense from the current $200,000 level to $325,000. What this means, of course, is that the disincentive part of the equation does not occur until a much more significant purchase has been made.

Increasing the expensing limit to various levels have been included actually in each of President Bush's major economic recovery and tax relief plans. However, the Section 179 increase has been dropped in the past and has not made it into law yet. I think it is important this year that we work hard to ensure that America's small businesses are included in any stimulus package. By increasing the expensing limit, I think our economy will improve, our business infrastructure will improve, and ultimately the lives of every day working Americans will improve.

I am pleased to have with us today Mr. Greg Jenner, who is on our first panel. He is the Deputy Assistant Secretary and Senior Advisor for Tax Policy at the United States Treasury. He is here

to discuss the importance of increasing the limit and provide some insights as to why the Administration feels this is important.

Before I recognize Mr. Jenner, I would be happy to recognize my colleague, our Ranking Member, if she has any comments she would like to make.

Ms. MILLENDER-MCDONALD. Thank you, Mr. Chairman, and good morning to all of you. I think the gridlock around here is getting about as bad as California's highways and freeways.

I am very pleased to be here with my colleague and our Chairman as we are holding this hearing to discuss this important proposal to help small businesses. We recognize that small businesses create the economic growth necessary to lift this country out of the current economic downturn, but they need an infusion of capital. One good way to do this is by increasing the amount that small businesses can deduct from equipment purchases. This will help businesses expand, spurring economic growth.

Now, this is a bipartisan solution that provides small employers with the right kind of assistance at a very critical point in our nation's history. In developing our economic recovery strategy, we must look at tax policies that create incentives for those sectors of the economy that are best equipped to promote economic growth. One of the best ways to accomplish this goal is to target small businesses.

Small businesses, as we know, create 75 percent of all new jobs, and they can pull America out of its current economic doldrums. History has shown that small firms have done this before and that we can do it again, but only if we give them the tools to do so.

I am pleased to see Mr. Jenner here as well. We welcome you. I thank you, Mr. Chairman. I will put my complete statement in the record.

Chairman TOOMEY. Thank you very much.

Mr. Franks, did you have an opening statement that you would like to make?

[No response.]

Chairman TOOMEY. In that case, Mr. Jenner, welcome. Thank you very much for being here this morning. We would be delighted to hear your testimony.

STATEMENT OF GREGORY F. JENNER, DEPUTY ASSISTANT SECRETARY AND SENIOR ADVISOR FOR TAX POLICY, UNITED STATES DEPARTMENT OF THE TREASURY

Mr. JENNER. Thank you very much, Mr. Chairman and distinguished Members of the Subcommittee.

My name is Greg Jenner. I am the Deputy Assistant Secretary of the Treasury for Tax Policy. On behalf of the Administration, I would like to thank you for affording us the opportunity to appear before you today regarding the President's proposal to expand and simplify expensing for small business.

As you know, Mr. Chairman, the expensing proposal is part of a larger jobs and growth package that the President has proposed

to sustain and grow the economy. The centerpiece of the President's plan is the elimination of the unfair double taxation of dividends. The dividend proposal will have a powerful effect, and I urge the Members of this Subcommittee to support it. As Chairman Greenspan noted, it will benefit all aspects of the economy, including small business and taxpayers at all income levels.

The proposed amendment to Section 179 of the Code is another key component of the President's jobs and growth package, and that will be the focus of my remaining testimony.

As you noted, Mr. Chairman, under current law, Section 179, taxpayers can expense up to $25,000 of equipment purchases each year instead of depreciating them. Off-the-shelf computer software is excluded because it is classified as intangible property. The $25,000 amount is reduced for each dollar of investment over $200,000. Neither the $25,000 amount nor the $200,000 is indexed for inflation.

An election under Section 179 must be made for each taxable year the expensed deduction is claimed. Once made, the election can only be revoked with the consent of the Commissioner. Current regulations provide that that revocation will only be granted in extraordinary circumstances.

The Administration has proposed significant modifications to Section 179. Our goal was to encourage and stimulate investment by small business, simplify tax compliance requirements and to reduce recordkeeping burdens. The Administration's proposal under Section 179 would do the following:

It will triple the amount that may be expensed to $75,000. It will index that amount for inflation annually. It will increase to $325,000 from $200,000 the point at which the benefits of Section 179 begin to phase at, and it will index that amount for inflation annually. Off-the-shelf computer software will be included as qualifying property, and taxpayers will be permitted to make or revoke expensing elections on amended returns without the consent of the Commissioner.

As you can see, Mr. Chairman, this proposal has importance far beyond increasing the amount that can be expensed each year. Expensing encourages investment by lowering the after tax cost of capital purchases. The Treasury estimates that for a typical seven year asset, expensing would reduce its cost of capital from .056 to .041.

I must note that these numbers were meaningless to me, too, being a lawyer and not an economist, but translated into its equivalent it is the equivalent of an investment tax credit of 8.5 percent for small business. Thus, the Administration's proposal will encourage small business to increase their capital investment while simultaneously stimulating demand for capital goods.

Second, expensing is far simpler than claiming depreciation, as you noted. This is particularly helpful for small business, many of whom are less able to afford sophisticated tax planning advice. The current $25,000 threshold, unfortunately, is low enough that taxpayers are often able to expense only a portion of the purchase price of an asset. This means that they lose any simplification benefits because they have to depreciate the balance of the purchase price. By raising the limit to $75,000, the President's proposal will

allow many more taxpayers to avoid the complexity inherent in depreciation.

Third, raising the level at which the phase out begins will increase the number of taxpayers eligible for expensing under Section 179. This will significantly simplify tax compliance and recordkeeping burdens. Without this change, the benefits from the proposed increase to $75,000 would be much more limited.

Fourth, including off-the-shelf computer software as qualifying property will eliminate confusion and inconvenience for many taxpayers who go out and purchase a computer and expense it, only to find that they have to depreciate the software because it is treated as intangible property.

Finally, permitting elections to be made or revoked on an amended return will provide flexibility to many small businesses who do not have the ability to hire sophisticated tax planning advice and who later discover they may not have wanted to expense or should have expensed and did not.

In conclusion, Mr. Chairman, the Administration believes that this proposal presents a winning combination of benefits, powerful incentives for small businesses to invest and grow, important simplification and reduced recordkeeping.

With the other components of the President's jobs and growth package, it will improve the climate for small businesses to lead the way to a stronger economy.

Thank you very much. I would be more than happy to answer any questions that you have.

Chairman TOOMEY. Thank you very much, Mr. Jenner. Excuse me, and forgive me for this cold this morning. I have a number of questions for you to begin with.

Mr. JENNER. Please.

Chairman TOOMEY. First is I want to just say for the record I wholeheartedly and enthusiastically share your view that the vital centerpiece of this package is elimination of the double taxation of dividends.

It has always struck me as irrational, a double taxation on capital formation, a disincentive to savings and investment, and a hurdle that we impose on the capital formation and savings in America, which in the long run I believe precludes us from reaching an optimal maximum economic growth level because we do not have the optimal level of capital formation because we actively discourage it with an irrational tax policy.

I want to commend you and the President for making that the centerpiece of this package. I think it is vital that we pass that.

Mr. JENNER. Thank you, Mr. Chairman.

Chairman TOOMEY. In addition, I think this is a very constructive measure to increase the amount that businesses can directly expense, and I am very, very supportive of this, but I would like to dig into the mechanics a little bit so that I make sure that we

all understand that and think about whether there might be perhaps even a better way to achieve this within this idea.

Am I correct in understanding that under current law a firm that has say $50,000 worth of tangible property purchases in a given year could expense $25,000, and the remainder would be depreciated?

Mr. JENNER. That is correct.

Chairman TOOMEY. But a firm that has $350,000 worth of tangible assets that they purchase in a given year would not be able to expense any?

Mr. JENNER. That is correct also.

Chairman TOOMEY. See, that strikes me as rather counterintuitive. A small business that has a greater need is not given the opportunity to expense anything at all.

I am wondering if you could share with us why is it that this trigger mechanism is used in the first place? Why is it that some businesses with greater needs are nevertheless forbidden from using this very helpful feature?

Mr. JENNER. Well, not being one of the original authors of Section 179 I can only speculate, but my guess would be, Mr. Chairman, that that is intended as a surrogate for measuring what is a small business. Instead of having an income limit—

Chairman TOOMEY. That is right.

Mr. JENNER. —the provision is measured by the amount of investment.

Chairman TOOMEY. That is what I suspected as well. Do you agree that it has the economic effect of creating actually a modest disincentive to be purchasing tangible property at the level that begins to reduce the amount by which you can expense?

Mr. JENNER. Absolutely.

Chairman TOOMEY. So it is kind of perhaps not intended, but a little counterintuitive. We create an incentive to buy a certain amount, $25,000 amount worth under current law. Then the Code is neutral with respect to another segment of tangible property that would be bought. Then there is actually an active disincentive to purchase more economically.

Mr. JENNER. Yes.

Chairman TOOMEY. And then after you have consumed and you have eliminated the entire opportunity to expense, then it goes back to being neutral in the sense that everything is depreciable.

Mr. JENNER. That is correct.

Chairman TOOMEY. It just strikes me as perhaps not the best mechanism. There are many other ways to measure what is a small business—total sales, size, for instance, number of employees, capitalization. There are a number of mechanisms.

Do you think it is worth considering other hurdles, other criteria for deciding who would get the benefit of this expensing provision?

Mr. JENNER. Well, I cannot make any promises, Mr. Chairman. I can certainly assure you that we take your concerns to heart and would be more than happy to work with you to see if there are other ways that we can measure what is a small business to eliminate the disincentives to invest margin.

Chairman TOOMEY. Yes. I was a small business owner for a number of years in the restaurant business. By I think all reasonable standards it was a small business, but there were many years in which we had requirements to make investments that would have and did in fact preclude us from taking advantage of this $25,000 expensing. I think many businesses find themselves in similar circumstances.

Mr. JENNER. Well, one of the reasons, Mr. Chairman, that we did want to increase that threshold is to make sure that more small businesses come within the larger amount—

Chairman TOOMEY. Right.

Mr. JENNER. —so that the margin is much higher and would only apply to a much smaller number of small businesses.

Chairman TOOMEY. And that proposal does do that. It increases from $25,000 to $75,000, but it also raises to $325,000 the amount of tangible property that could be purchased before the sort of disincentive component kicks in.

Mr. JENNER. That is correct.

Chairman TOOMEY. It strikes me that that is particularly important for many start up companies who are small businesses, but can easily incur $200,000 or $300,000 in purchases to get started, so this proposal allows more people to participate, as well as allowing the amount by which they benefit to grow. Is that correct?

Mr. JENNER. Absolutely correct, Mr. Chairman.

Chairman TOOMEY. All right. Thank you very much.

I would at this time recognize the gentlelady from California.

Ms. MILLENDER-MCDONALD. Thank you so much, Mr. Chairman.

I suppose the question has always been what is a small business, and I guess that definition has not been defined. For that reason, a lot of this that you have outlined today is laudable, but when you look at small businesses in my district I wonder just what advan-

tage they would have in this, and I suppose that is the question that I raise to you.

To get a sense of the businesses that will be utilizing this change, I would like to know how many businesses currently elect to expend and, even more so, how many minority businesses and how many women owned businesses.

Mr. JENNER. Ms. Millender-McDonald, I am not certain of the latter two questions, and I am not completely certain that our data would break that down, although I promise you I will go back and check.

Of the number of businesses that are claiming expensing currently, that number approaches 4.2 million annually.

Ms. MILLENDER-MCDONALD. And yet we are saying 4.2 million annually contingent upon the definition of small business?

Mr. JENNER. That is correct.

Ms. MILLENDER-MCDONALD. And exclusive perhaps of minority and women owned businesses?

Mr. JENNER. That number would include all businesses, minority and women owed. I just do not know what—

Ms. MILLENDER-MCDONALD. Predicated on what we define as a small business?

Mr. JENNER. Correct.

Ms. MILLENDER-MCDONALD. Okay. Given that, I think you can recognize the burden that is placed on a lot of minority owned businesses, so to talk about the double taxation of dividends, while that might be something that is very creative and I applaud the President for that and you, too, that does not register a lot with small businesses in my district.

For that, I would have to go back and really kind of reassess, depending on what we will finally define as a small business, as to how this package that you have laid out would benefit the community that I serve. Certainly that of Watts and Compton would perhaps have some concerns about that, given the already burdensome provisions and burdensome task that they have in trying to just stay afloat irrespective of.

While I do think that some kind of tax incentives, some type of tax policy is absolutely needed for small businesses, I will have to go back and really assess whether the package that you have outlined to us this morning would benefit those who are trying to create jobs in the southern California region.

Of course, Los Angeles and Long Beach, cities in my district, would perhaps receive this much better than those who are in the much needed area of my district, so to talk about this and to talk about 75 percent of equipment purchased would perhaps be something that I would need to talk with them on.

I thank you for being here. The expensing is great if in fact the businesses that I have, the small businesses, would even have the notion of looking at this package and looking at the whole notion of expensing.

Thank you, Mr. Chairman.

Mr. JENNER. Mr. Chairman, if I might add, I promise you, Congresswoman, that we will get back with you as to whether we have that data. If we do, we will get it to you.

Chairman TOOMEY. Thank you, Mr. Jenner, and I thank the gentlelady from California.

At this time I would recognize the gentleman from Arizona, Mr. Franks.

Mr. FRANKS. You know how the freshmen are. They have to turn on their microphones. Thank you, Mr. Chairman.

Mr. Jenner, just for the sake of the Committee just for clarity and fundamentals, this Section 179 here, can you tell us exactly how that would change the deduction? I understand now that the first $25,000 within a given amount of capital purchase is deductible. Can you just give us the numbers as they are now and how they would change? Sometimes restating the obvious is helpful.

Mr. JENNER. That is quite all right. The $25,000 amount would triple to $75,000, so the first $75,000 of capital purchases would be expensible rather than depreciable.

Under current law, the benefits of that $25,000 begins to phase out dollar for dollar beginning at $200,000. That amount under the President's proposal would be increased to $325,000, and thus, because we are increasing the amount that can be expensed from $25,000 to $75,000, it would phase out dollar for dollar from $325,000 to $400,000.

We would also make certain other changes, more technical changes. For example, those amounts would be indexed each year so as inflation increased or decreased the value of those dollar amounts would go up. We would also allow software, which currently does not qualify for expensing because it is not tangible property, to be treated as qualifying property.

We would also allow taxpayers to make or revoke their election to expense without the consent of the Commissioner, which gives them more flexibility to plan or to correct a mistake if they make one.

Mr. FRANKS. Thank you, sir. You know, it always occurs to me that whenever we talk about anything to do with the economy we forget that the fundamental measure of economy is productivity.

This seems to be an obvious incentive to productivity, which helps everyone that is any part of the chain in the economy. I applaud you for your efforts here and certainly support very strongly what you are trying to do here.

Mr. JENNER. Thank you, Mr. Franks.

Mr. FRANKS. Thank you, Mr. Chairman.

Chairman TOOMEY. Thank you.

I would recognize now the gentleman from Colorado, Mr. Beauprez.

Mr. BEAUPREZ. Thank you, Mr. Chairman. I apologize for being a little late. I was busy with another Committee responsibility doing a mark up. I am glad to be here for part of this testimony, though.

I most recently was a community banker, and the vast majority of my clientele at our bank were small business owners. We specifically through our bank worked with an organization called Colorado Micro Credit that helped many very small businesses, people looking for a few hundred dollars for their first loan to maybe get some tools to become a landscaper or an electrician's toolbelt, that simple.

I recall one gentleman that started a bar-b-que sauce company and simply needed the bottles and the equipment to make his bar-b-que sauce. It has grown into quite a business for him. It is very rewarding, as you can imagine, to see.

I do not know that I have ever seen a proposal come from Congress that has been so enthusiastically embraced as the increasing of the expensing allowance. I think to modernize that is a good step. $25,000 today is not what $25,000 used to be. I would ask at the end of my comments if you would enlighten me, and perhaps you already have, so if you have with my apologies again, how you arrived at $75,000, as opposed to some other number.

I think this will stimulate the economy very well. As I have gotten in the habit of putting it, if we can encourage capital investment by business, which has been lagging for a little over two years now, if we can encourage that and do it with not just a stimulus, because when we stimulate we tend to poke it here and it comes out there, and then we poke back later. I would like to see us do it with good, sound economic policy, and that is what I think this is.

If somebody buys, as you just alluded to, software or a computer or a washing machine or a drill press, a metal lathe, somebody has to design it. Somebody has to fabricate it. Somebody has to assemble it. Somebody has to ship it. Somebody has to make the packaging to ship it in. Somebody has to unpackage it, put it on the shelf, retail it, deliver it, install it and service it. That is how we create jobs in this economy. I have had the pleasure again of being the community banker for all of those small businesses in that chain. That is I think productive.

The same, frankly, with the dividend proposal. I have been so encouraged with the volume of jobs that are projected in the economic model that will be created by that, and the fact is, as I understand it, over half of the people that pay the dividend tax are senior citizens now, which makes sense. They are people like my mom and dad who have got a little bit of their savings in an investment account of one type or another. I think this is sound economic policy. Is it perfect? I do not know. Time will tell. I applaud you for the direction.

Now that I have given you my side of the equation, and obviously I am encouraged by this, tell me how the $75,000 number was arrived at.

Mr. JENNER. Certainly, Mr. Beauprez. First let me say that we have always agreed that the availability of capital has never been a problem for Fortune 100 companies. Availability of capital is a problem, a huge problem, for small business. That is what motivated the President to include this proposal.

The $75,000 number was arrived at in part by looking at statistics, seeing where the various levels of investment were for small business, again recognizing that we had to draw lines, but trying to draw the line high enough so that we captured the vast bulk of small businesses, making sure that the number was high enough and the phase out range was high enough so that we did not enlarge on one end and squeeze on the other.

We think that we have drawn the line in such a way that the vast bulk of small businesses will be able to benefit from the proposal. As you say no proposal is ever perfect, but we think that we have gotten it as close as we can possibly get.

I am not sure I gave you a direct answer to your question, but—

Mr. BEAUPREZ. Well, I think I heard you say it is a judgment call.

Mr. JENNER. Certainly.

Mr. BEAUPREZ. I accept that. Again, the vast majority—I had an electrician in my office just the day before yesterday. He is an electrical contractor. He is very excited about this.

Again, if we can encourage and stimulate capital investment once again, I think that is what has been sorely lacking. That will be a great stimulus, a positive one, but a long-term one that I think we will see benefits from.

Thank you, Mr. Chairman. I yield back.

Chairman TOOMEY. Thank you. Mr. Jenner, thank you very much for your helpful testimony.

At this time, I would invite the second panel to seat themselves at the table.

Welcome, everybody. Let me introduce the folks on our second panel today. We are very grateful to have each of you with us today. To begin with we will hear testimony from Dr. Martin Regalia. He is the chief economist and vice president for tax policy at the United States Chamber of Commerce.

Dr. Regalia, welcome. I congratulate you on your advocacy on small business issues. Dr. Regalia will give us his take on the current economic landscape and explain the benefits of raising the expensing limit not only to small business, but also to the American economy as a whole.

I also want to welcome Ms. Dena Battle, manager of legislative affairs at the NFIB, National Federation of Independent Business. Welcome. Ms. Battle will discuss her membership's thoughts on the expensing limit.

Mr. Les Shapiro, president of the Padgett Business Services Foundation, is also with us today. Mr. Shapiro will explain how from an accounting point of view the Section 179 comes into play in the decision making process for his clients.

We also have with us today Mr. Brian Harvey, president of H&C, Inc. of Laurel, Maryland. H&C is a small heating and cooling service company with 28 employees. Mr. Harvey will be sharing his experiences with Section 179 as a small business owner himself and how the limit impacts his daily operations.

Thank you all for joining us. At this time I would recognize Dr. Martin Regalia.

STATEMENTS OF MARTIN REGALIA, CHIEF ECONOMIST AND VICE PRESIDENT OF TAX POLICY, U.S. CHAMBER OF COMMERCE; DENA BATTLE, MANAGER, LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; LES SHAPIRO, PRESIDENT, PADGETT BUSINESS SERVICES FOUNDATION; AND BRIAN HARVEY, OWNER, H&C, INC. HEATING & COOLINGSTATEMENT OF MARTIN REGALIA

Mr. REGALIA. Thank you very much. My name is Marty Regalia. I am the chief economist and vice president for tax and economic policy at the U.S. Chamber of Commerce. We applaud you, Mr. Chairman, for holding these hearings, and we thank you for the opportunity to testify on behalf of small business expensing provisions that are—

Chairman TOOMEY. Excuse me, Dr. Regalia. Could you move the microphone a little closer to your mouth, please?

Mr. REGALIA. We are happy to be here today to comment on the small business expensing provisions that are included in the President's jobs and economic growth package.

Recently released data show the U.S. economy to still be searching for confidence, balance and momentum. While the real economy has grown over the past five quarters, the growth has been erratic and somewhat anemic. It has averaged only 2.9 percent, and that is below the economy's potential, and it is insufficient to create new jobs. In fact, over the same time period the economy has lost about 1.3 million jobs. This quarter, the growth rate is probably less than two percent, and jobs are still being lost.

While the Fed have cut interest rates about as far as possible, it is now up to the Congress to pass effective economic growth legislation such as the President's jobs and growth plan. We support the entire plan and strongly urge you to pass it as quickly as possible.

In recent years, the importance of small business to our economic growth and prosperity has been unparalleled. Small enterprises and start up companies form the foundation of our economic prosperity. Furthermore, small businesses have traditionally accounted for most of the nation's new job growth.

It would make sense then that any attempt to increase growth in jobs should have a strong small business component. One way we can achieve this is to reform the Tax Code small business cap-

ital expensing provisions. Currently the recovery of investment in capital expenditures by a small business sector is limited by antiquated depreciation rules and anemic allowances under the Internal Revenue Code Section 179. Tax implications affect the timing of small business investment, as well as whether or not the investment is actually undertaken. Small business owners are keenly aware of the impact of the U.S. Tax Code on their decisions.

In the year 2000 Treasury report, the Treasury noted that the current depreciation system is dated, is not indexed for inflation, and does not provide for investment and separate depreciation rules for new types of assets, new activities and new production techniques.

The problem would best be remedied through full expensing of business equipment. At the very least, the amendment of Section 179 to allow progressively greater expensing amounts and enhanced phase outs is warranted. Such measures would spur additional investment in business assets and lead to increased productivity, creation of more jobs and greater economic growth, and I believe that is good public policy.

Current proposals, such as the one embodied in the President's jobs and growth plan, would go a long way toward enabling and enticing the nation's small business to increase their investment in productivity enhancing business property.

The President's Section 179 expensing provision would triple the maximum deduction and introduce enhanced phase out levels, stemming the erosion in the value of this depreciation deduction that would otherwise occur over time. This in turn would further augment current cash flow and encourage and enable these companies to invest in new machinery and equipment, increasing their productivity, providing a further boost to the economic sector that produced and serviced these items.

In sum, the funds would be used to grow businesses, to boost the nation's economic growth and create new jobs. We believe that the President's package in total is what is needed to get this economy going, to move this economy from just below its potential to just above its potential and to start creating new jobs.

This particular provision is directed at small business investment. It is a provision that is long overdue and will be a big help in encouraging these businesses, which are the primary driver of the U.S. economy, to take on more investment and create more jobs.

Thank you very much.

Chairman TOOMEY. Thank you, Dr. Regalia.

At this point I welcome and introduce for testimony Ms. Battle.

STATEMENT OF DENA BATTLE

Ms. BATTLE. Good morning, Mr. Chairman, Mr. Ranking Member and distinguished Members of the Committee.

My name is Dena Battle, and I am testifying on behalf of the 600,000 members of the nation's largest small business group, the National Federation of Independent Business. On their behalf, I appreciate the opportunity to discuss the importance of Section 179

expensing legislation and the impact it will have on small businesses.

Today's uncertain economic times are especially tough on our small business owners. They tend to experience economic ripples harder and faster than anyone else. Thus, small business owners tend to be an early warning system for our economy's health.

The most recent small business economic trends report revealed that sales for small businesses have continued to decline, reaching the lowest levels registered in the past two years. In addition, our small business optimism index fell three points in February, another alarming plunge. Most small business owners are not optimistic that the economy is recovering right now.

Allowing small business owners to expense critical investments is a key component of an expanding economy since this money will be used immediately to purchase products, grow business and create new jobs. Under current law, the majority of NFIB members' growth is limited because they exceed the small business expensing limit in the first three months of the year. If this expensing exemption is increased, well over 1,000,000 small businesses would be able to purchase equipment and grow their business, and that will result in overall economic growth.

This issue is more about people than it is about numbers. Carolyn Galvin, owner of Storeel Corporation, says that she is going to quadruple the investments that her company will make this year if expensing limits are increased. She plans to upgrade her PCs, buy new table saws and possibly purchase a new forklift. Another NFIB member that I talked to about this issue said the increases in Section 179 limits would allow him to hire three new employees, and that is real economic growth.

Another crucial element in the President's proposal for Section 179 is the increase in the investment limit. The current investment limit penalizes small business owners for making substantial business investments. Increasing the investment limit to $325,000 as proposed will encourage business owners to make decisions based on business considerations, not tax considerations.

The Tax Code, with all of its complexities, takes time away from a business owner's focus on running and expanding his or her business. If that business owner is able to expense rather than depreciate, it gives them the time to focus on running their business, not filling out tax forms.

These small businesses are major job creators in local economies, and that means that they contribute dramatically to local tax bases as well. According to a recent Bureau of Labor Statistics projection, small firm dominated sectors of the economy have or will contribute more than 60 percent of the new jobs from 1994 to 2005.

Small business owners have survived and served as this nation's job growth engine, despite the economic challenges that they have faced over the last two years. By lifting this burden, we will help them to reach their full potential and be able to see the true power of the American entrepreneurial spirit.

Thank you, Mr. Chairman, for your leadership on this issue and for holding this important hearing.

Chairman TOOMEY. Thank you very much, Ms. Battle.

At this time I welcome and would introduce Mr. Shapiro for his testimony.

STATEMENT OF LES SHAPIRO

Mr. SHAPIRO Thank you, and good morning. It is a pleasure to be here today on behalf of Padgett Business Services.

Padgett has approximately 300 offices in the U.S. It provides accounting and tax services exclusively to small business clients. Small business is our exclusive client base. We define small business as those with fewer than 20 employees. As a practical matter, most of the clients Padgett serves are comprised of five or fewer employees, many of them mom and pop operations. We are proud to represent their interests.

When contacted a few days ago about whether or not Padgett could possibly be here with you this morning, believing that an accountant's perspective could balance this panel, we were pleased to consider the matter. However, a significant problem we had in that regard was that this time of year is not the time to find an accountant available to be with us.

Consequently, we made the decision that I would get the job by default. We respect the endeavors of the Small Business Committee and its Subcommittees, so here I am, even though I am not an accountant and, for that matter, not a practitioner. However, I have worked with accountants most of my professional life and am familiar with accountants' experiences, with their mind sets and even with their souls.

Increasing the Section 179 limit from $25,000 to $75,000 ostensibly should be welcomed by small business owners and those who serve them. We applaud the effort of the President to recognize the special circumstances of America's small business owners and to provide them needed breaks with respect to their taxes and paperwork burdens.

Certainly the ability to write off as much as $75,000 in the year of purchase of business equipment is a good thing. Life would be somewhat simpler for the small business owner. He or she no longer would have to deal with annual calculations, such as depreciation, for most purchases and would have significant tax savings with which to enhance the business through such things as increased marketing, employee benefits and hiring new employees.

With that said, we do not see the immediate tax saving necessarily as a planning tool. Our experience shows that the small business clients we serve do not make substantial equipment purchases frequently. When they do, it is based on their judgment that the equipment is needed and that its purchase is the right thing to do. They are going to buy the equipment under any circumstance.

Consequently, the tax saving often becomes secondary during the planning phase. It is an unexpected bonus, an incentive perhaps. Let me emphasize that this is not to belittle the tax saving, but to demonstrate that such saving is not always the dominant force in our clients' planning strategies.

We respectfully suggest that there are some alternatives and expansions to the concept that appear relevant. As already suggested,

our experience shows that the real world of small business is such that small business owners do not spend more than $25,000 on equipment in most years, at least not our client base. Spending more than $75,000 would be rare. However, there are obvious exceptions to this.

An alternative that may be prudent is that in those years where there is an excess of the maximum amount spent, be it $25,000 or $75,000, the taxpayer would be able to carry forward the difference between what was actually spent and the maximum for the 179 allowance. There, of course, would have to be a great deal of structure to a program of this nature. However, we believe this would be a significant benefit to small business owners.

Yet another concept that would be helpful to them is to expand the definition of purchases to which 179 would apply. There is greater potential for financial harm to a small business owner who builds a new structure on his or her property or who makes needed repairs to existing real estate than for the purchase of a new piece of equipment.

We have listened to stories from our clients and even within the Small Business Committee family that the small business community would be well served by coming to terms with the problem by expanding the tax benefits for all business investments of the nature I have discussed.

For example, the cost of a new roof for a business structure is such that the depreciation schedule may outlive the life of the business and/or its owner. Helping the owner at the front end would be sound and consistent with the President's commitment to small business.

Again, thank you, and, of course, I will welcome any questions.

Chairman TOOMEY. Thank you, Mr. Shapiro.

At this time I would like to welcome and introduce for his testimony Mr. Harvey.

STATEMENT OF BRIAN HARVEY

Mr. HARVEY. Good morning. Thank you, Mr. Chairman and Committee Members.

On behalf of the Air Conditioning Contractors of America, ACCA, I would like to thank you for providing me this opportunity to testify today on this very critical issue to small business.

ACCA is the national non-profit trade association that represents the technical, educational and policy interests of the men and women who design, install and maintain indoor environmental systems. We are the folks who keep your homes warm in the winter and cool in the summertime. We have over 50 federated chapters with approximately 5,000 local, state and national members. Most are family owned businesses, many in the second and third generations.

I presently serve as president of the National Capital Chapter of ACCA. In addition to being an active member of ACCA, I am the owner-operator of H&C, Inc. based in Laurel, Maryland. I have 28 full-time employees, and we have been in business since 1969. I am a real, live business person.

My testimony today is to strongly urge the Congress to adopt the proposed changes to Section 179 of the Internal Revenue Code contained in President Bush's economic stimulus plan.

Like most small business people, operating my business sometimes is a lot like a juggling act. Vehicle purchases are a big thing for us. When I purchase a vehicle, I look at which guy wants a new truck. Then,there are guys who should have a new truck, but they do not want a new truck because they are emotionally attached to their old truck. Then there are usage issues. You have a guy who is working out of a pick-up truck. As his career progresses, his responsibilities change. He may change over to a van to do a different type of related service in our industry.

Thrown in that mix I have to cosider recently available rebates, financing incentives, all of these with deadlines, many with year-end deadlines. So all these things are thrown into the mix. Like most things in life, it comes down to a matter of dollars and cents. Can I afford to make such a purchase? If I do, what are the tax implications and incentives?

Service vehicles are the life blood of my business. I have to go to my customers. My customers cannot come to me. If your furnace breaks, you cannot bring it to my warehouse to get it fixed. I have to come out there. Our particular company offers 24 hour service 365 days a year, so our trucks are running almost constantly, tens of thousands of miles a year. We try to maintain them as best as we can, but their life span generally is a matter of three to five years.

This particular issue is of extreme importance to me because in December I needed two new vehicles. I ended up purchasing one only because I could not take the deduction for the second one until this year, so I delayed the purchase of it until this calendar year.

As a result, I probably was not able to get as good a deal. If you walk into a dealership and you are buying two trucks you certainly have their attention better than if you are buying just one vehicle. However, my whole 179 expensing allowance was used up in one vehicle. Honestly, that was the sole determining factor in not buying the second truck.

Understand, too, that when I buy a vehicle I buy the truck and then I send it to another company to get ladder racks and tool bins installed. That is $1,500 or so in someone's pocket. Then I send it down the road to the guy who letters the truck. That is $500. Most likely it will get upgraded. When I get a new truck the technician will say, "I have to have new stuff." They get new tools, new ladders, new safety gear, the whole nine yards. It is not just the vehicle, but it is a whole conglomeration of things.

It is not just vehicles. My business actually manufactures the sheetmetal ductwork. We do that in-house. I have a 15-year-old piece of machinery. Its replacement cost is $70,000. I would like to proactively replace that piece of equipment, but I will not. One day I am going to come into the shop, and it is not going to work. Then I am going to say "okay, now I have to buy the new one."

There are a lot of people like myself. A couple things she mentioned. You know, we need a new forklift. There are lots of things that we need. Given a tax incentive, yes, I would be stimulated to spend money. I really would.

Thank you.

Chairman TOOMEY. Thank you very much, Mr. Harvey.

I would like to actually start my first question, if I could, with you. It is interesting. Your personal experience seems to differ from the general indication that Mr. Shapiro suggested for his clients.

Mr. Shapiro, correct me if I mischaracterize your opinion on this, but it seemed to me that Mr. Shapiro's judgment was that most purchases made by at least his clients are driven by the need for the equipment or the absence of need and that the tax treatment is sometimes not even known and not a significant consideration.

It sounds to me like because it is part of the cost of that item, it very much weighs on your judgment when you are making a purchase. In fact, am I correct in assuming that it could actually change your decision in a given year as to whether or not to make a purchase?

Mr. HARVEY. It did in fact in December. I delayed the purchase of a vehicle. Actually, the truck that was getting replaced ended up needing a new transmission in January.

Chairman TOOMEY. Would you say that if the President's proposal had been the law in effect last year, would you have bought two trucks instead of one?

Mr. HARVEY. Honestly, I probably would have bought three.

Chairman TOOMEY. You probably would have bought three trucks?

Mr. HARVEY. Yes, sir.

Chairman TOOMEY. Instead of one truck?

Mr. HARVEY. Yes, sir.

Chairman TOOMEY. That strikes me as a big difference.

Another question for Mr. Harvey, if I could. You are probably aware of this, but your customers, when they go out and buy new air conditioning and heating units, they are not able to take advantage of this expensing provision because it is excluded from the qualified property under Section 179.

Now, if we broadened the kinds of property that would qualify for this, which is something I think Mr. Shapiro suggested that we consider, expanding the kinds of property that would qualify, do you think that would have a positive impact on your business?

Mr. HARVEY. When he mentioned the roof, I kind of got a cold chill. My building is going to need a new roof soon. I thought holy smokes. Yes.

Chairman TOOMEY. Yes. I was wondering if perhaps Ms. Battle or Dr. Regalia might be able to suggest any kind of statistics that might help us with regard to either the percentage of small busi-

ness or the number of small business or any other way to quantify how many folks might be able to benefit from an increase in the amount that could be expensed?

In other words, is it true that $25,000 is such a large purchase that very few people ever go over that, or is it your opinion that there are many, many small businesses that routinely buy more than that, and it would benefit them? Is there any way to quantify that? What is just your judgment intuitively?

Mr. REGALIA. Well, I am sure there are ways to quantify it, and I am sure the Treasury has some numbers that are not always accessible to us outside of the government in terms of the gradations of people around the point that they mention.

About 4.2 million people take this deduction right now. We know there is somewhere in the neighborhood of 20,000,000 businesses. As you start to expand both the amount of the deduction from $25,000 up to $75,000 and you also increase the phase out limits, I think you start to expand quite significantly the amount of businesses that would see this deduction as a real benefit.

When you start to work then on the type of qualified expenditures that can be taken you expand even again, so I think that my judgment is that this would be a substantial increase to move from $25,000 to $75,000, to move the phase out from $200,000 up to $325,000, and to expand the qualified types of investment. It still would fall short of what we would really like to see, which is full-time expensing for these type of expenditures.

Chairman TOOMEY. Yes, and I am a big believer in full expensing for all of these things.

I guess another way to look at this is if you look at the way the joint Tax Committee and the Treasury quantifies this as a cost to the Treasury, the implication is that there would be literally millions of businesses that would benefit from this further expansion.

Ms. Battle, did you have anything to add to that?

Ms. BATTLE. Well, I was just going to say I think the Administration's numbers right now say about 4.1 million are able to use expensing. I know that the numbers under the new proposal would add another 508,000 that would be eligible in addition to those that are already eligible, so that is a substantial number.

Another thing I would just say outside of the numbers is many of our businesses, many of our members, some of their most substantial investments come in the first year as they are starting up. I think that speaks to how crucial this is now as these small businesses are trying to get started and get going in a struggling economy. This will help them dramatically. I think that is an important point to make.

Chairman TOOMEY. Right. One other qualifying point, if I could make it, as our tax expert, Mr. Clark, informs me, that in just such a case where someone would incur a large cost and perhaps not have the income against which to fully enjoy the benefit, current law does allow you to carry forward that—

Ms. BATTLE. Correct.

Chairman TOOMEY. —expensing provision so that in a future year when you do have sufficient income you still capture the value of that expensing provision.

Thank you. At this point I would be happy to yield to the gentlelady from California.

Ms. MILLENDER-MCDONALD. Thank you so much. This has been a very interesting panel. The dichotomy of the small businesses and their concerns really did show the range here today.

Mr. Regalia, indeed we have lost I think in excess of 1.3 million jobs now as we tend to calculate more, and I am so happy that the Chamber of Commerce supports this expensing proposal. If you had to choose between the dividend tax cuts and the increased expensing, what will the Chamber push for?

Mr. REGALIA. That is kind of a Sophie's choice really. I think that the Chamber right now is supporting the entire President's package. We believe that the package as a whole shows a remarkable balance in terms of who it tries to help and how it tries to help them. It has a short run stimulus of a significant nature, and then it does things like this which encourage longer term investment.

If you try to do one and the other, you end up, you know, kind of being a sprinter in a long distance race. You will start out of the gate quickly, but then you will run out of gas. This type of provision gives you that long-term stamina. It increases your ability over time to continue to grow.

You know, I would be very hesitant to try and pick winners and losers in the President's package. When you look at the dividend portion, it does a number of things. It has immediate stimulus. It lowers the cost of capital, which would stimulate investment among bigger firms. It increases or will increase the stock market, which has wealth effects, all of which create demand. Much of that demand is satisfied by smaller firms.

Also when you look at investment, much of the type of investment that businesses across the board take on is satisfied, is produced by smaller firms, and so what you are trying to do with this package is to create an environment where everybody can find their niche and grow. It does not just help one. It really tries to help all.

This particular piece is a very, very important piece, but it still has to, you know, be remembered that it is a piece. What we would like to see is the entire package because when we look at the economy right now we see an economy that is still losing momentum. It is just not the war. The stuff that happened in the early 1990s after we won the last Gulf War definitively, we still saw two or three years of sub-par economic growth.

I think the President recognized that this time around. I think we are going to win the war, but then we have to win the economic war. This is the type of package that will help do it. This piece is a very important part.

Ms. MILLENDER-MCDONALD. Well, the economy was flourishing in the latter part of the 1990s. You will have to admit to that. Certainly after 9-11 I think a lot of that had an impact on the economy as well, given the state that we have found ourselves in given 9-11.

I will ask you. Have you defined what a small business is with reference to the Chamber of Commerce? If in fact you have, do you think this package would be an important one for small businesses that have fewer than 20 employees?

Mr. REGALIA. Well, I think it is interesting. When we look at the Chamber's membership, we have about 90 percent or so that are small businesses, about 70 some percent that are less than 10 employees small businesses, which I would call very small businesses.

The SBA defines small business I believe in some of their data up to 300 employees and in other data up to 500 employees.

Ms. MILLENDER-MCDONALD. Yes. That is correct. It varies.

Mr. REGALIA. You know, rather than put a limit on or to try and label a business as small or large, I mean, if you talk to individuals that have 100 employees they think of themselves as kind of medium sized, but in many cases they operate very similar to smaller businesses. I do not think you gain anything by that limit.

We think of businesses that are in this range as being of a small business nature, and we think that, you know, they do not have some of the access to capital that businesses that employ many more people and are larger in terms of their net revenues and their gross revenues.

Ms. MILLENDER-MCDONALD. But I think we do have to look at small businesses irrespective because when we talk about entrepreneurialship and we try to get people to come into this whole notion of that, of course, then we have to look at that range from the lower to the perhaps 100, 500 or whatever. I think with that then it does become an important factor.

Mr. REGALIA. Absolutely. Taking an entire package and focusing different pieces on different parts of the picture, the mosaic that you are trying to create, is a very good way to go. I think the President did it with this package. This piece certainly is an integral part, is a part that adds tremendously to the overall package and should be included in any bill that is passed.

Ms. MILLENDER-MCDONALD. I would like to ask the question to I guess all of you except Mr. Harvey because I suppose the answer would be yes with him. Would you like to see the expansion of the qualified types of investments to include that of roofing and air conditioning and others that have been outlined by Mr. Shapiro?

Mr. REGALIA. Yes, we would.

Mr. SHAPIRO Of course we support it.

Ms. MILLENDER-MCDONALD. Yes, of course. I should have left you out of that equation as well.

Just one other question, Mr. Chairman, if I might ask Mr. Shapiro. You said that the dominant force is a strategy far beyond what has been outlined in this proposal. Can you quickly tell me what that dominant force might be for those clients of yours?

Mr. SHAPIRO For tax planning?

Ms. MILLENDER-MCDONALD. For tax planning, yes.

Mr. SHAPIRO For planning purposes, not necessarily tax planning.

Ms. MILLENDER-MCDONALD. Yes.

Mr. SHAPIRO I think that our client base recognizes that a purchase of any sort with or without the tax benefit will still cost them money.

I found Mr. Harvey's statement about his buying three trucks a little scary because his business will still be out the difference between the tax saving and whatever is left over. I think that is the difference.

It may be an incentive, and I think there is a difference between incentive and planning. As an incentive it may be a tiebreaker in making the decision to purchase the additional equipment or the new equipment or the replacement equipment, but not necessarily the dominant force.

Would you spend $10 to save $2? You know, a good business answer is maybe. It all has to factor into it. It is very difficult for us, based on our client base, to say that the 179 limit is the dominant force in planning.

Chairman TOOMEY. Thank you.

Ms. MILLENDER-MCDONALD. Mr. Chairman, let me just say that this has been a very interesting panel of people. Thank you so much.

Chairman TOOMEY. Thank you very much.

The gentleman from Arizona?

Mr. FRANKS. Thank you, Mr. Chairman and panel. I just appreciate so much, as everyone does, you coming here. I mean, you folks are certainly the leaders of this economy. You are the ones that make it all work for all of us.

I just wanted to ask perhaps a hypothetical question, but sometimes, you know, when you are new you are not caught up in the institutional inertia, and you just think well, what would happen if we all became appropriately obsessed with free enterprise here and just simply said that since there is some consensus in this country that providing jobs is a good thing and that buying equipment that other people have to build is an incentive to build jobs

is a good thing, and providing services to people and products to people is a good thing.

What if we just became completely obsessed with free enterprise and said we are going to allow businesses in general, big, small or indifferent, to expense as they do, of course, their payroll, their equipment purchases and just about anything that goes to productivity?

Am I just new, or is it something that would really make a difference in this economy? Is this something that any loss that we had in revenue to the government by taxing some of those things, would it not be made up significantly more in the added productivity that it would incentivize, and would it not be a lot better for our economy in general? I mean, somebody take a shot at it.

Mr. REGALIA. Well, I think that clearly the ability to expense would enhance the overall investment in the economy, which would in turn improve productivity growth, and that expands or increases the potential rate of growth of the economy, the jobs creating rate of growth, and is the definition of what standard of living is in an economy. It would increase the standard of living.

You know, certainly you have transitional periods because the Treasury is used to collecting revenues on a staggered basis, but once that was done you are really not reducing the amount of revenue that the Treasury collects in total over time. You are changing the timing of it.

Once you get through that timing problem you then have a situation where, to the discussion that was taking place earlier, you remove the Tax Code from the investment decision, and that would be a benefit to the economy as well so that you would make decisions on when you need trucks.

I mean, you do not buy a truck to save $2. You buy a truck to service your customers. You have to service your customers when they need that service, so you take the expense when you have to take it within reason, but you adjust at the margin for changes or aberrations in the Tax Code.

To remove that from the Tax Code is a benefit to allow business decisions to be made on the basis of need rather than on the basis of a Tax Code, especially one that is not all that up-to-date. I think it would have a profound impact on the economy to move to outright expensing.

When you look at what a good Tax Code would be as kind of defined in theory, and this is theory that is included in a number of books, textbooks that we studied years ago, it includes immediate expensing. It removes the double taxation on savings, removes the double taxation on things like dividends.

One of the things that it does in this vein is also to allow for expensing in the year in which the purchase is made.

Mr. FRANKS. Mr. Chairman, I just agree with the gentleman so very much. It just occurs to me. I am a former small business owner, and, you know, we have somehow this class battle over making sure that we be hard on the business people and the corporations, but I just would perhaps just remind the group that if we do take away corporations' profit and their ability to do things

we take away corporations. We take away business. We take away everything from everyone.

It just occurs to me that if we want to tax something, let us tax the profits on corporations. Let us tax the things that they do not put back into the economy. That is probably an appropriate place to do it if we are going to do it.

The idea of being able to let corporations expense those things that all of us agree is good activity for this economy just seems fundamentally positive for everyone in the economy. I do not know why we somehow stumble over what seems to me to be an obvious truth.

Thank you, Mr. Chairman.

Chairman TOOMEY. Thank you.

The gentleman from Colorado?

Mr. BEAUPREZ. Thank you, Mr. Chairman.

An observation, first of all. I think we rightfully, understandably are focusing on the direct beneficiary or at least the potential beneficiary if these rules were changed, if these updates were made, the small businessman who suddenly could expense three times as much of his capital investments.

I hope, Mr. Chairman, we do not lose sight of the fact that there are indirect beneficiaries too, and a great many of them, people that are going to be supplying whatever goods that are being acquired. Somebody has to make those and deliver those and that whole speech again.

A question for at least Ms. Battle and Dr. Regalia, and maybe the other two would like to respond as well. Mr. Shapiro, I will use your comment as the takeoff for this question. I accept the premise that many small businesses —before I was a banker, I was a dairy farmer, and certainly, you know, if the tractor died we went and got another one. You did not have much choice. Need probably predicates tax planning in many cases. I accept that.

Here is my question. My sense, and the two of you here on the right from your membership's perspective please respond. My sense is that given the times we are going through these kind of uncertainties, and there is just kind of a knot in the belly of a lot of people, that there has been a holding back of purchases that might otherwise take place, be that a new truck, be it adding another employee, be it upgrading office equipment, be it whatever.

If one could do that with pre-tax dollars, as opposed to post-tax dollars, we might provide a little bit of encouragement to get on with those purchases, those investments, and untie that knot in the belly. Have you any sense from your membership as to whether I am on track or not?

Ms. BATTLE. Our membership certainly indicates that this would be substantial in their decisions on what to purchase. Most of our businesses are, as you know, very small and independently owned.

Mr. BEAUPREZ. If I can interrupt, what is the average size, employee base, of your businesses?

Ms. BATTLE. About five. These are very small businesses. These people have taken a substantial risk to open a business, and they are very concerned. They think long and hard before they make a purchase. I do think that changes in the Tax Code do have a significant impact on how they make their decisions.

They are aware that this is part of the President's package, and they contact us regularly. They let us know that this will be something that will affect their decision making when they purchase things.

Mr. REGALIA. I think everything you do in the tax area affects somebody at the margin. Is it going to change someone's mind that was not going to make any expenditure to suddenly do one? Probably not. What it does is it reduces the cost of the expenditure. It leaves the business with more choices as to where to allocate their scarce resources.

When you start to do that in small amounts across a wide number of companies, you start to see a profound impact in the economy as well. That in turn generates more demand, which in turn drives the need for even more investment.

Everything in the economy is connected. You cannot affect one end without in some way affecting somebody down the road or up the stream from where you are. That is why the entire package is such an important and well crafted package. It stimulates demand. It encourages investment. It works towards short-term growth. It encourages people to make decisions and allows them to make those decisions in a less costly fashion that in turn creates the entire economy and spurs that overall economic growth.

This is an important piece. Small business is an important piece of the economy. This will allow them to make the decisions they want to make. It will provide them the wherewithal to make those decisions when they want to make them instead of having to look to the Tax Code, instead of having someone in Mr. Shapiro's firm say oh, do not do that now. Wait until next month, or wait until next year. That kind of waiting slows the entire economy down.

Mr. BEAUPREZ. Thank you.

Mr. Chairman, I yield back.

Chairman TOOMEY. Thank you. That obviously indicates a vote. We have 15 minutes, which gives us plenty of time for the five minutes for the gentleman from Pennsylvania who has no questions?

Mr. GERLACH. I have no questions.

Chairman TOOMEY. In that case, I would thank very much all of our witnesses on the first panel and the second panel.

Ms. MILLENDER-MCDONALD. May I just say one word?

Chairman TOOMEY. I will yield to the gentlelady from California.

Ms. MILLENDER-MCDONALD. Thank you, Mr. Chairman. It has been great to start this year off with you as the Ranking Member on this great Committee.

We have heard from small businesses, from a different range of businesses, from different types of businesses, and I think this is a plus when we begin to deliberate and to move the agenda of the President's package.

Again, I thank all of you for coming today. It is going to be a pleasure to work with you.

Chairman TOOMEY. Thank you. The feeling is mutual. I thank all the witnesses for being here, as well as the Members.

This hearing is adjourned.

[Whereupon, at 11:20 a.m. the Subcommittee was adjourned.]

Subcommittee on Tax, Finance, & Exports
Opening Statement of Chairman Patrick Toomey
on
Small Business Asset Expensing
April 3, 2003

Good morning, thank you all for coming. Today, we are going to examine potential changes to Section 179 of the Internal Revenue Code. The provision of the tax code that limits the amount a small business may directly expense in a given year versus what can be depreciated over time.

The reason we need to examine this issue is because small businesses are the key to our economic recovery and getting people back to work. According to the Small Business Administration three out our every four new jobs are created by small businesses. In total, they represent more than 99% of all employers and employ 51% of private sector workers and 51% of workers on public assistance.

As the economy continues to struggle in response to the recession that began in March 2001, we are witnessing a great strength of small business in their resilience while driving our economy. That said, our small businesses are still struggling. We must create an environment where America's small businesses can thrive, and in turn, lead our country back to a growing economy.

Beyond being the major source of employment, new and small firms play a key role in economic growth. The entrepreneurs that have courage to start a business are the innovators, creating whole new industries, products and ideas and in the process are the first to hire new workers when the economy begins to expand and fight to be the last to lay-off workers when the economy contracts. They are continual sources of new ideas that might otherwise remain untapped—and their experimental efforts are an essential part of the organic and ever-changing American economy.

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $25,000 amount is reduced by the amount by which the cost of qualifying property placed in service during taxable year exceeds $200,000. In effect, this rule gives firms an incentive to invest no more than $200,000 by substantially increasing their asset cost above the threshold range.

We must look at ways to foster growth from within small businesses, and Section 179 can certainly play a major part. In a perfect world, I would like to see the end of depreciation schedules, allowing both large and small businesses to expense everything, providing an immediate and healthy boost to the business community. Realizing that we cannot get to that point over night, an excellent place to start is increasing the direct expensing limits under Section 179 of the Internal Revenue Code.

Anything that simplifies regulations, and particularly tax regulations, disproportionately reduces costs for small business owners. A study done for the Small Business Administration's Office of Advocacy in 1999 put the cost of compliance with tax regulations by small business at just over $1200 per employee for businesses with fewer than 20 employees. This is more than twice what it costs companies with more than 500 employees.

Depreciation and the record keeping that goes along with it is a complex and time consuming process. For a small business that may be doing cash accounting expensing the costs of equipment purchases is much easier and much more realistic.

In his latest economic stimulus proposal, President Bush has made increasing the Section 179 limit to $75,000 a priority. As an integral part of the President's economic stimulus plan, increasing this limit works in conjunction with other aspects, such as accelerating the individual marginal tax rate reductions and reducing the taxation of capital income in the form of the dividend and capital gains tax cuts.

In addition to raising the expensing limit, the President's plan indexes the limit to inflation so that our small businesses can change with the times. The President's plan also raises the threshold limit to $325,000, allowing some of our larger small businesses to further grow and expand their businesses.

Increasing the expensing limit to various levels has been included in each of President Bush's major economic recovery/tax relief plans (Public Laws 107-16, 107-147, and the current plan). However, the Section 179 increase has been dropped before either of the first two plans was signed into law. This year, we must diligently work to ensure that America's small businesses are included in any stimulus package.

By increasing the expensing limit, I believe our economy will improve, our business infrastructure will improve, and the lives of every-day Americans will improve.

I am pleased to have with us today Mr. Greg Jenner, Deputy Assistant Secretary and Senior Advisor for Tax Policy at the U.S. Treasury to discuss the importance of increasing the limit and provide insight as to why the Administration feels this is an important issue.

Also with us today is Dr. Martin Regalia, Chief Economist and Vice President for Tax Policy at the U.S. Chamber of Commerce. Dr. Regalia, welcome, and I congratulate you on your advocacy on small business issues.

Dr. Regalia will give us his take on the current economic landscape, and explain the benefits of raising the expensing limit not only to small businesses, but also the American economy as well.

I also welcome Ms. Dena Battle, Manager of Legislative Affairs at the National Federation of Independent Businesses. Ms. Battle will discuss her membership's thoughts on the expensing limit.

Mr. Les Shapiro, President of the Padgett Business Services Foundation is also with us today. Mr. Shapiro will examine how, from the accounting firm point of view, Section 179 comes into play with his group's clients' business plans.

We also have Mr. Brian Harvey, President of H & C, Inc. of Laurel Maryland. H & C is a small heating and cooling service company with 28 employees. Mr. Harvey will be sharing his experiences with Section 179 as a small business owner, and how the limit impacts his daily operations.

Opening Statement of Congresswoman Juanita Millender-McDonald

Ranking Member, Subcommittee on Tax, Finance and Exports
2360 Rayburn House Office Building April 3, 2003 – 10:00 a.m.

"Small Business Expensing: Increasing Incentives for Small Companies to Grow and Invest in their Businesses"

Mr. Chairman, I am pleased that we are holding this hearing to discuss this important proposal to help small businesses. Small businesses create the economic growth necessary to lift this country out of the current economic downturn, but they need an infusion of capital.

One good way to do this is by increasing the amount that small businesses can deduct for equipment purchases. This will help businesses expand -- spurring economic growth. This is a bi-partisan solution that provides small employers with the right kind of assistance at a very critical point in our nation's history.

In developing our economic recovery strategy, we must look at tax policies that create incentives for those sectors of the economy that are best equipped to promote economic growth.

One of the best ways to accomplish this goal is to target small businesses. Small businesses create 75% of all new jobs -- and they can pull America out of its current economic doldrums.

History has shown that small firms have done it before and they can do it again - but only if we give them the tools to do it.

Effective tax reforms can aid entrepreneurs in many ways as they launch a new business or grow existing ones, meaning more jobs. Though the increased expensing provision makes up only three percent of the Administrations' growth package, it could do more for this country's economic recovery than any of the other tax reform proposals currently under consideration.

The proposal to raise the expensing level from $25,000 to $75,000 will provide an immediate boost to small businesses. It creates incentives for small companies to invest their dollars back into their businesses. It also provides the cash infusion they need in the year they make these large purchases rather than over a number of years. For some companies, this could mean as much as $17,500 more a year that can be invested in new and more productive equipment.

Raising the expensing level will encourage many reluctant small business owners to invest during these uncertain times.

As the economic indicators in this country have continued to decline, so has the willingness of entrepreneurs to put money at risk. Many small businesses are looking for that extra push. This proposal effectively provides that push and can help jumpstart an economic recovery for the entire nation.

Small businesses have been calling for an increase in expensing since the start of the recession, yet they have seen no action. The expensing increase is in both the Administration's and Democratic stimulus plans because it provides small enterprises with the tools they so desperately need to grow their businesses.

This is a tax change targeting companies that are expanding, investing, adding jobs and growing the economy. It is a tax cut designed to meet the particular needs of small businesses that account for 99 percent of employers, and make up half of this country's GDP.

Clearly, our economy needs some help, but we must be smart and develop proposals that target a key sector of the economy -- small businesses. I look forward to hearing from the witnesses -- not just on their support for this provision -- but their thoughts on how we are finally going to get this done.

STATEMENT

Padgett Business Services

House Small Business Committee

Subcommittee on Tax, Finance and Exports

Hearing

Small Business Expensing: Increasing Incentives for Small Companies to Grow and Invest in Their Businesses

April 3, 2003

Leslie S. Shapiro, President

Padgett Business Services Foundation

It is my pleasure to participate at this hearing on behalf of Padgett Business Services. I am Les Shapiro, president of the Padgett Business Services Foundation. Padgett Business Services, with corporate offices in Athens, Georgia and Westwood, Massachusetts, has approximately three hundred offices in the United States. It provides accounting and tax services to over 15,000 small business owners. Small businesses are Padgett's exclusive client base. We define small businesses as ones with fewer than twenty employees. This, in fact, constitutes approximately 85% of our nation's small businesses. As a practical matter, most of the clients Padgett serves are comprised of five or fewer employees, many of them "mom and pop" operations. We are proud to represent their interests.

A significant problem we had in connection with this hearing was to find an accountant available to do the job at a time of the year so close to the end of the tax filing season. Since we respect the endeavors of the Small Business Committee and its Subcommittees, we want to be as helpful as possible. As a result, the responsibility for testifying was mine by default, even though I am not an accountant or, for that matter, a tax practitioner. However, I have worked with the accounting industry for most of my professional career and am familiar with accountants' experiences, their mindsets, and even their souls.

Increasing the section 179 limit from $25,000 to $75,000 ostensibly should be welcomed by small business owners and those who serve them. We applaud the effort of the President to recognize the special circumstances of America's small business owners and to provide them needed breaks with respect to their taxes and paperwork burdens. Certainly, the ability to write off as much as $75,000 in the year of the purchase of business equipment is a good thing. Life would be somewhat simpler for the small business owner. He or she no longer would have to deal with annual calculations, such as depreciation, for most purchases and would have significant tax savings with which to enhance the business through such things as increased marketing, employee benefits, and the hiring of employees.

With the above said, we do not see the immediate tax saving necessarily as a planning tool. Our experience shows that the small business clients we serve do not

make substantial investments frequently. When they do, it is based on their judgment that the equipment is needed and that its purchase is the right thing to do. They are going to buy the equipment under any circumstance. Consequently, the tax saving often becomes secondary during the planning phase. It is an unexpected bonus. This is not to belittle the tax saving, but to demonstrate that such saving is not always the dominant force in our clients' planning strategies.

We respectfully suggest there are some alternatives and expansions to the concept that appear relevant. As already suggested, our experience shows that in the real world of small business, most small business owners do not spend more than $25,000 on equipment in most years. Spending more than $75,000 would be rare. However, there obviously are exceptions to this. An alternative that may be prudent is that in those years where there is an excess of the maximum amount spent, such as $25,000 or $75,000, the taxpayer would be able to carry forward the difference between what was actually spent and the maximum for the section 179 allowance. There, of course, would have to be some limitations to a program of this nature. We believe this would be a significant benefit to small business owners.

Yet another concept that would be helpful to them is to expand the definition of purchases to which section 179 would apply. There is greater potential for financial harm to a small business owner who builds a new structure on his or her property or who makes needed repairs to existing real estate than for the purchase of a new piece of equipment. We have listened to stories from our clients and even within the Small

Business Committee family that the small business community would be well served by coming to terms with the problem by expanding the tax benefits for all business investments of the nature discussed. For example, the cost of a new roof for a business structure is such that the depreciation schedule may outlive the life of the business and/or its owner. Helping the owner at the front end would be sound and consistent with the President's commitment to small business.

Again, thank you for the opportunity to participate at this hearing. I will be pleased to try to answer your questions and to furnish you any additional information that may be of assistance to you.

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Air Conditioning Contractors of America

2800 Shirlington Road · Arlington, VA 22206 · (703) 575-4477 · Fax: (703) 575-4449

TESTIMONY ON SMALL BUSINESS EXPENSING: INCREASING INCENTIVES FOR SMALL COMPANIES TO GROW AND INVEST IN THEIR BUSINESSES

BEFORE THE SUBCOMMITTEE ON TAX, FINANCE, AND EXPORTS OF THE HOUSE COMMITTEE ON SMALL BUSINESS

SUBMITTED BY
BRIAN HARVEY, PRESIDENT
H. AND C. INC.

APRIL 3, 2003

Chairman Toomey, and members of the Subcommittee on Tax, Finance, and Exports of the House Committee on Small Business, on behalf of the Air Conditioning Contractors of America (ACCA), thank you for providing me the opportunity to testify today on this very critical issue to small business. ACCA is the national non-profit trade association that represents the technical, educational and policy interests of the men and women who design, install, and maintain indoor environmental systems. We have over 50 federated chapters with approximately 5,000 local, state, and national members. Most are family-owned businesses, many in the second and third generations.

In addition to being a member of ACCA, I am the owner-operator of H and C Inc. based in Laurel, MD and have 28 full time employees. I also serve as President of the National Capital Chapter of ACCA.

My testimony today is to strongly urge the Congress to adopt the proposed changes to Section 179 of the Internal Revenue Code contained in President Bush's economic stimulus plan.

As you know, Section 179 of the Internal Revenue Code allows small business to expense (i.e. take a tax deduction) a limited amount of the cost of business equipment purchased each year. The current cap on the amount that can be depreciated is $25,000 a year for taxable years 2003 and beyond. However, this benefit is further limited by a provision that stipulates that the expensing amount is phased out dollar for dollar for any amount of investment above $200,000 in a given year.

The expensing caps have not been indexed for inflation and therefore their value has decreased overtime. As a result, the code no longer reflects the

cost of our capital needs. Section 179 is not providing the economic stimulus that it might. Like most small business people, operating my company is akin to a juggling act. For example, I am constantly weighing the options of purchasing new vehicles...which employee needs a new truck, which trucks need to be replaced because of mechanical issues, which trucks are obsolete due their type (i.e. is a van better suited for a particular individual rather than a pickup truck), and who's got a '"deal" going on financing or rebates. But more importantly, can I afford to make such a purchase, and if I do, what are the tax implications or incentives?

Service vehicles are the lifeblood of my business. I have eight vans and thirteen pickup trucks. They are on the road daily and are worked extremely hard. They require constant upkeep and we put tens of thousands of miles on each one every year. Even though we maintain them as best we can, their lifespan is a matter of three to five years. At the end of last year I needed two new vehicles. I purchased one in December and delayed the purchase of the other until this year because of the limitation imposed by section 179 of the tax code. As a result, I wasn't able to negotiate the best price because I didn't have the bargaining power of buying two at once. One vehicle used up my 179 expensing allowance, and that was the determining factor in delaying purchase of the second truck.

The bottom line is I've had to operate my company based upon the tax code rather than the operational needs of my business.

Were section 179 increased to $75,000 and indexed to inflation as provided in the president's stimulus plan, I could have purchased both vehicles at the same time. Besides saving me money, it would have provided added stimulus to the economy last year. I would also have had less disruption of my business because of the decision to delay purchase of the second vehicle.

The situation is the same this year. I have several vehicles that need replacing but given the $25,000 limit, I will probably hold off on one or more of them. If you increase the section 179 deduction to $75,000, I will buy more trucks this year. This helps the truck manufacturer, my local truck dealer, the company who outfits the vehicle with tool bins and ladder racks, and the sign painter down the street who letters the trucks.

Here's another example. I'm also in the sheet metal manufacturing business, which provides the ducts to accompany the heating and cooling equipment we install and service. How you handle the expensing issue will also determine how often I upgrade my machinery. For my business, I can only purchase machinery every few years because of the expense. Every purchase is done with careful consideration. Additional tax benefits under section 179 would certainly help me upgrade on a more rapid schedule.

The proposed legislation by Congressman Wally Herger (H.R. 179) and Senator Olympia Snowe (S. 158) is taking the expensing issue in the right direction. Their bills call for increasing the expensing limit to $75,000 and the phase out to $325,000, and of course, index the caps for inflation. To repeat. Passage of these measures would not only benefit our small community-based

businesses but also provide a needed boost to the overall economy by stimulating the purchases of more equipment.

Finally, I would be remiss if I did not take this opportunity to remind the committee of a related item in the tax code that also places an unfair burden on small businesses as mine. As you know, section 280F of the tax code deals with vehicles used in business that weigh 6,000 pounds or less. It prohibits a small business from claiming a full depreciation deduction for the vehicle because the allowable limit is only $14,460 (for vehicles placed in service in 2000), while most vehicles in this category sell for $22,000 to $30,000. We have asked the Treasury Department to update their guidance to reflect today's realities and would hope that you would join us in encouraging the Agency to make the changes. We specifically asked for greater flexibility in the definition of a van and a truck. When the law was last updated in 1984, the definition of vans and trucks predated the creation of whole classes of vehicles, including the mini-van, used in today's service business.

The new guidance should focus less on the definition of the vehicle but more on the manner in which it is being used. We seek guidance that recognizes the new vehicle types without strict regard to weight limits. We urge Treasury to change the dollar limits to reflect today's costs and also index the limits. Finally, we urge them to permit the business owner to apply section 179 expensing rules to these vehicles. Ironically, Treasury has had the authority to exempt any truck or van from the limits on depreciation under section 280F but for some reason, they have never done so. They need a nudge.

As I stated at the start of my testimony, most of ACCA's member companies are family-owned businesses. Your support for these measures would demonstrate recognition of the unique challenges we small business people face every day. By increase the deductibility of our equipment, you can help us grow our businesses and create more jobs. And, you will be helping the economy in these difficult times.

Thank you for your attention and this opportunity.

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

Embargoed Until Delivery
April 3, 2003

Contact: Tara Bradshaw
(202) 622-2014

**TESTIMONY OF GREGORY F. JENNER,
DEPUTY ASSISTANT SECRETARY (TAX POLICY),
UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON TAX, FINANCE AND EXPORTS OF THE
HOUSE COMMITTEE ON SMALL BUSINESS
ON SMALL BUSINESS EXPENSING**

Mr. Chairman and distinguished members of the Subcommittee:

On behalf of the Administration, I would like to thank you for the opportunity to appear before you today regarding the President's proposal to expand and simplify expensing for small business. To address our economic security, President Bush has proposed his Jobs and Growth Plan. The Jobs and Growth plan will create and secure jobs, accelerate and sustain our recovery, increase workers' standards of living and increase the economic performance of our nation right now and for many years to come. Furthermore, it will stimulate consumer spending and small business investment in the near term by letting workers and owners keep more of their earnings and will increase savings and investment for job creation and retention through the elimination of the unfair double taxation of dividends--the single most powerful thing we can do to sustain and grow the economy. We urge Congress to pass this plan in its original form, true to its intentions. Let me highlight why we feel so strongly on this point.

First, taxing the same income twice is simply unfair. This proposal is necessary to fulfill the President's principle that business income should be taxed once, but only once. Second, the dividend proposal will have a powerful effect on growth in the economy. As Chairman Greenspan noted, this will benefit all aspects of the economy, including small business, and taxpayers at all income levels. Third, it will strengthen job retention and increase job creation, resulting in about 40% of the new jobs provided by the plan. Fourth, the elimination of the dividend tax will have a beneficial impact on the stock market, especially helping pensions, 401Ks, and seniors' retirement income. Fifth, this will also give consumers a lift by increasing their sense of well being. Finally, it will increase corporate accountability by taking away incentives for excessive debt and questionable mergers and acquisitions. As Secretary Snow has said, earnings are an opinion, but cash is a fact.

In addition to increased expensing, let me highlight additional benefits for small business in the President's plan. All small businesses, including sole proprietorships, partnerships, S corporations, and C corporations, benefit from the President's Jobs and Growth Package. Owners of flow-through entities directly benefit from all individual income tax reductions, including rate reduction, marriage penalty relief, expansion of the 10-percent tax bracket, and child credit expansion. 23 million owners of flow-through entities receive an average tax reduction of $2,042 from these provisions. For example, a small business owner with $50,000 of business income from a flow-through entity will receive a tax reduction of $1,000 to $1,800 from accelerating the rate reduction alone. Owners of C corporations directly benefit from all of the changes benefiting flow-through owners and additionally benefit from the elimination of the double taxation of corporate income. Small business owners of a C corporation would enjoy substantial tax savings regardless of whether they distributed their after-tax earnings or retained them. This will undoubtedly promote small business profitability and job creation. For example, owners of a C corporation with $50,000 of taxable income that distributes all of its after-tax corporate income would enjoy tax savings of between $2,089 and $6,405 depending on their own individual tax bracket. C corporation small business owners who retain a portion of their after-tax corporate income would also enjoy substantial current tax savings. For example, owners of a C corporation with $50,000 of taxable income that distributes one-third of its after-tax corporate income would enjoy tax savings of between $2,090 and $5,380 depending on their own individual tax bracket. Owners of larger C corporations also would benefit.

As you know, the proposed amendment to section 179 of the Internal Revenue Code is a key component of the President's Jobs and Growth package, and that will be the focus of my remaining testimony..

Current Law

Under current law, section 179 provides that, for taxable years beginning in 2003, in lieu of depreciation a taxpayer with annual investment below a certain level may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property includes tangible personal property, purchased for use in the active conduct of a trade or business, which is subject to an allowance for depreciation. Off-the-shelf computer software, however, is excluded from current expensing under section 179 due to its classification as intangible property for purposes of federal income taxation.

The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. Neither the $25,000 nor the $200,000 amounts are indexed for inflation.

An election under section 179 must be made for each taxable year the expense deduction is claimed for qualifying property. The election must provide certain specific information as required by the statute and the corresponding income tax regulations, and the election must generally be attached to the taxpayer's tax return for the taxable year to which the election applies. Once made, the election can only be revoked with the consent of the Commissioner and current regulations provide that such revocation will only be granted in extraordinary circumstances.

Section 179 is generally viewed as a simplification measure for small business to obtain a current deduction for property used in their trade or business. Current expensing of depreciable assets significantly reduces the administrative complexity that would otherwise exist if such assets were recovered over a number of years under the general depreciation rules. Section 179 also provides small businesses with a lower cost of capital for their depreciable assets.

Administration's Proposal

In an attempt to encourage and stimulate investment by small businesses, simplify tax compliance requirements, and reduce record-keeping burdens, the Administration has proposed significant modifications to section 179 specifically designed to meet these important policy goals. The Administration's proposal under section 179 would do the following:

(1) triple the maximum dollar amount that may be expensed to \$75,000 (from \$25,000) for qualifying property placed in service in 2003 and thereafter;
(2) index annually for inflation the amount that can be expensed each year (beginning in 2004);
(3) increase to \$325,000 from \$200,000 the point at which the benefits of section 179 begin to phase out, effective for qualifying property placed in service in 2003 and thereafter (and index such amount annually for inflation);
(4) include off-the-shelf computer software as qualifying property; and
(5) permit taxpayers to make or revoke expensing elections on amended returns without the consent of the Commissioner.

As you can see Mr. Chairman, this proposal has significance far beyond increasing the amount that can be expensed each year.

The benefits of the Administration's proposal on small business taxpayers as well as the overall economy are many. For example, expensing encourages investment by lowering the after-tax cost of capital purchases compared to claiming annual depreciation deductions. We estimate that for a typical 7-year asset, expensing would reduce its cost of capital from 0.056 (excluding the benefits of the temporary 30 percent partial expensing provision) to 0.041. This benefit is equivalent to an investment tax credit rate of 8.5%, assuming a full basis adjustment. In addition, the Administration's proposal to increase the annual deduction limitation will encourage small businesses to increase their capital investment as a result of the reduced after-tax cost while simultaneously stimulating the economy vis-à-vis an increase in the manufacture of capital goods.

Second, expensing is far simpler than claiming regular depreciation deductions. This is particularly helpful for small taxpayers less able to afford sophisticated tax planning advice. Economic data indicate that of all taxpayers that claimed a section 179 deduction in 1999, 69% of those taxpayers were sole proprietorships or individual farmers. The proposal will further simplify tax compliance requirements by eliminating the often tedious task of depreciating fixed assets over a number of years. The current \$25,000 threshold is low enough that taxpayers often are able to expense only a portion of an asset's purchase price. The taxpayer is required to depreciate the balance, which eliminates any simplification benefits. Capital investment for small businesses in particular is likely to vary substantially year by year. One year a business may make no capital purchases and in the

next buy a $50,000 piece of equipment. Under current law, they would receive none of the simplification benefits of expensing. By raising the limit to $75,000, the President's proposal will allow many more taxpayers to avoid the complexity inherent in depreciation.

Third, raising the amount of total investment at which the phase-out begins increases the number of taxpayers eligible for Section 179 expensing, thus simplifying the tax compliance and record keeping burden for a significant number of small business taxpayers. Without this change, the benefits from the proposed increase in the amount that can be expensed from $25,000 to $75,000 would be much more limited.

Fourth, current section 179 precludes off-the-shelf computer software from being expensed. This is confusing and inconvenient to many taxpayers who buy a computer, expense it, but then have to depreciate (amortize) the software they bought to run on the computer. The simplification gains of expensing the computer are largely lost if the software has to be depreciated. Current law also places purchased software at a disadvantage relative to software developed specifically for the taxpayer. Under current law, the cost of packaged software that is purchased "off-the-shelf" is amortized over 36 months whereas costs to develop software are generally permitted to be expensed as incurred. The Administration's proposal to include computer software as qualifying property eligible for immediate expensing will increase the scope of property eligible for current expensing, provide similar treatment relative to developed software, and further simplify the tax compliance burdens of small business.

Finally, current law section 179 does not permit taxpayers to revoke their 179 election on an amended return. While the tax code does not generally allow elections to be made on amended returns, the Administration believes an exception is justified in this instance. Taxpayers, such as small businesses, without the resources to hire experienced tax advisors, are often unaware of the advantages or disadvantages of the increased deduction. Therefore, to permit elections to be made or revoked on an amended return will provide flexibility to these smaller businesses in determining whether the election is to their advantage and will permit the less-advised taxpayers to avail themselves of the benefits offered under section 179.

Usage of Section 179 Under Current Law and Under the Administration's Proposal

Table 1 provides data on the usage of section 179 in 1999 (the most recent year for which data is available) by type of business. It shows that 4.2 million small businesses claimed $26.1 billion in section 179 deductions.[1] Most of these businesses – 61 percent – were sole proprietorships. Twenty-seven percent were corporations (11 percent C corporations and 16 percent subchapter S corporations), 8 percent were farms, and 4 percent were partnerships. Sole proprietorships also claimed the largest amount of section 179 deductions -- $11.2 billion -- followed by corporations with $10.5 billion, farms with $2.9 billion, and partnerships with $1.5 billion.

Table 2 shows the amount of section 179 deductions claimed broken out by the amount of total investment in section 179 property. It shows that the vast majority of businesses using section 179

[1] The limit on section 179 deductions was $19,000 in 1999.

make only small amounts of investment, whether or not it is expensed.[2] In 1999, when the maximum deduction allowed under section 179 was $19,000, businesses with an investment of less than $25,000 in property that would qualify for section 179 treatment represented 85 percent of all businesses claiming section 179 and 61 percent of the investment expensed. The remaining 15 percent of businesses claiming section 179 deductions, those making $25,000 or more of potential section 179 investment, accounted for 39 percent of the expensing.

There are at least two ways to examine which businesses would benefit from the Administration's proposal. One way would be to look at businesses who would qualify for larger section 179 deductions under the proposal than under current law, without any changes in their behavior. Another way would be to look at businesses for which the proposal provides an incentive to change their behavior and increase their investment in order to receive more generous treatment than they would under current law. Table 3 takes the former no-change-in behavior approach to benefits, and Table 4 looks at businesses that the proposal might encourage to make larger investments.

At 1999 levels of investment, about one-half million small businesses would have directly benefited if the Administration's proposed deduction and phase-out limits had been in effect rather than current 2003 law. (Table 3) This figure represents businesses that had enough business income and who made enough investment that they could have claimed a larger section 179 deduction under the higher limits of the proposal, with no change in behavior on their part. Interestingly, more of these beneficiaries were S corporations than any other type of business, followed by C corporations. Although a majority of current users of section 179 are sole proprietorships, they represent only 23 percent of the direct beneficiaries.

Businesses who could have claimed higher section 179 deductions under the more generous limits are only one group who would benefit from the Administration's proposal. The more generous provisions also provide incentives for a number of businesses to increase their investment in property qualifying for section 179 expensing. As Table 4 shows, the Administration's proposal provides an incentive for 1.8 million small businesses, or 42 percent of all businesses claiming section 179 deductions, to increase their investment in qualifying section 179 property. (Column 2) These were businesses that claimed some expensing but invested less than $75,000 in section 179 property in 1999 and that had adequate business income to qualify for a larger deduction. The proposal would provide an incentive to increase investment to approximately two-thirds of all S corporations and partnerships who currently claim section 179. Because sole proprietorships make up such a large share of the current users of section 179, sole proprietors represent over half of the businesses that would be encouraged to increase their investment. (Column 3)

These measures of the number of small businesses that would benefit from the Administration's proposal – either directly with no change in behavior or by responding to new incentives to increase investment -- are a lower bound on the number of businesses that would be helped by the proposal. These counts do not include firms that will now be able to expense software purchases, which would make or revoke section 179 elections on amended returns, or might for the first time be encouraged by the more generous expensing previsions to purchase qualifying section 179 property. In addition,

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2 This total amount of investment in property that could qualify for section 179 expensing is referred to here as "potential section 179 investment."

these figures don't capture the total number of small businesses that in a 5-year period would at some point be able to benefit from expanded eligibility for section 179.

Conclusion

Consequently, Mr. Chairman, the Administration believes that this proposal presents a winning combination of benefits: powerful incentives for small businesses to invest and grow, important simplification, and reduced recordkeeping. With the other components of the President's Jobs and Growth package, the proposal will improve the climate for small businesses to lead the way to a stronger economy.

Table 1. Businesses Claiming Section 179 Deductions in 1999 - by Type of Business

	Number of Businesses Claiming Section 179		Amount of Section 179 Deductions Claimed		
	(in units)	%	Total (billions of $)	%	Average (in $)
All Businesses	4,189,000	1.000	26.1	1.000	6,200
C Corporations	457,000	0.109	4.4	0.170	9,700
S Corporations	682,000	0.163	6.1	0.233	8,900
Sole Proprietorships	2,540,000	0.606	11.2	0.429	4,400
Partnerships	170,000	0.041	1.5	0.058	8,900
Farms	340,000	0.081	2.9	0.110	8,400

Office of Tax Policy, US Treasury Department April 3, 2003

Source: Unpublished data from IRS Statistics of Income

1/ "Potential unclaimed section 179 deductions" = the amount of investment made by the taxpayer in property potentially eligible for section 179 that is not claimed under section 179. Section 179 property is defined in the IRS Code as "any tangible property (to which section 168 applies) which is section 1245 property." It excludes section 50(b) property and air conditioning and heating units.

Table 2. Businesses Claiming Section 179 Deductions in 1999
By Amount of Potential Section 179 Investment 1/

Amount of Potential Section 179 Investment 1/	Number of Businesses Claiming Sec. 179		Amount of Sec. 179 Investment Claimed		
	Returns (in units)	Percent	Total (billions of $)	Percent	Average ($)
$1-25,000	3,543,000	0.846	15.9	0.608	4,500
$25,000-30,000	129,000	0.031	1.8	0.071	14,300
$30,000-40,000	143,000	0.034	2.2	0.083	15,100
$40,000-75,000	213,000	0.051	3.5	0.134	16,400
$75,000-400,000	159,000	0.038	2.7	0.103	16,800
Total *	4,189,000	1.000	26.1	0.999	6,200

Office of Tax Policy, US Treasury Department April 3, 2003

Source: Unpublished data from IRS Statistics of Income

* Total includes some firms whose section 179 investment exceeds the phase-out range because of section 179 deductions carried over from prior years when the firm had insufficient business income to use the full section 179 deduction, or because of more generous limits for investment in Empowerment Zones.

1/ "Potential section 179 investment" = total amount of a taxpayer's investment in property eligible for section 179, whether or not the taxpayer claims it or is eligible to claim it (because of limitations on the deduction or insufficient business income). Section 179 property is "any tangible property (to which section 168 applies) which is section 1245 property." It excludes section 50(b) property and air conditioning and heating units.

Table 3. **Businesses Directly Benefiting from Administration's Proposal 1/**
1999 Levels of Investment

	Number of Direct Beneficiaries (in units)	Number of Direct Beneficiaries Percent distribution
All Businesses	508,000	1.000
C Corporations	130,000	0.256
S Corporations	167,000	0.329
Sole Proprietorships	116,000	0.228
Partnerships	47,000	0.093
Farms	48,000	0.094

Office of Tax Policy, US Treasury Department April 3, 2003

Source: Unpublished data from IRS Statistics of Income

1/ Businesses benefiting from Administration's proposal = businesses claiming section 179 deductions but making $25,000-$400,000 in potential section 179 investments plus businesses ineligible to claim section 179 deductions because they made over $225,000 in section 179 investments. Businesses benefiting also have sufficient business income to qualify for increased section 179 deductions.

Table 4. **Businesses that would benefit if they increase their investment in response to the proposal 1/**

	Beneficiaries	Beneficiaries as % of all returns claiming sec. 179 deductions	Distribution of beneficiaries
	(1)	(2)	(3)
All Businesses	1,770,000	0.423	1.000
C Corporations	207,000	0.453	0.117
S Corporations	436,000	0.639	0.246
Sole Proprietorships	915,000	0.360	0.517
Partnerships	116,000	0.682	0.066
Farms	96,000	0.282	0.054

Office of Tax Policy, US Treasury Department April 3, 2003

Source: Unpublished data from IRS Statistics of Income

1/ "Businesses that would benefit if they increase their investment" = businesses claiming some section 179 deduction in 1999 who have adequate business income to increase their deduction and who have less than $75,000 in investment in property eligible for section 179.

Statement of the U.S. Chamber of Commerce

ON: SMALL BUSINESS EXPENSING

TO: HOUSE COMMITTEE ON SMALL BUSINESS SUBCOMMITTEE ON TAX, FINANCE, AND EXPORTS

DATE: APRIL 3, 2003

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 71 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business – manufacturing, retailing, services, construction, wholesaling, and finance – numbers more than 10,000 members. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 94 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
SMALL BUSINESS EXPENSING PROVISIONS
for submission to the
HOUSE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON TAX, FINANCE, AND EXPORTS
by the
U.S. CHAMBER OF COMMERCE

April 3, 2003

The U.S. Chamber of Commerce appreciates this opportunity to express its views on small business expensing provisions. The U.S. Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. This breadth of membership places the Chamber in a unique position to speak for the business community.

THE ECONOMIC ENVIRONMENT

Recently released data show the U.S. economy to be one that is still searching for confidence, balance, and momentum. While real economic growth has been positive over the five quarters ending last December, growth has been erratic and has averaged only 2.9% -- below the economy's potential and insufficient to create new jobs. In fact, over that same time period, the economy has lost about 1.3 million jobs. An important issue will be whether Congress can pass effective economic stimulus and growth legislation, such as the President's Jobs and Growth Plan.

Although some recent monthly data show enough incipient signs of improvement to keep the nation hopeful that the economy will accelerate in the future, policy initiatives are clearly warranted. With the Fed having cut interest rates about as far as possible, fiscal policy appears to be our only remaining choice.

THE NEED FOR SMALL BUSINESS TAX REFORM

In recent years, the importance of small businesses to our economic growth and prosperity has been unparalleled. As economic statistics confirm, maintaining a healthy environment for small businesses to proliferate contributes greatly to our economic expansion and raising our standard of living. Small enterprises and startups form the foundation for our future economic prosperity.

Furthermore, small businesses have traditionally accounted for most of our nation's job growth. According to statistics from the Small Business Administration, small businesses represent ninety-nine percent of all employers and generate two-thirds to three-quarters of all net new jobs. It would make sense, then, that any attempt to stimulate the economy by job creation through fiscal policy should have a strong small business component.

It is sound economic policy and in the best interest of our country that small businesses be encouraged and nurtured through the promotion of tax policies that allow them the opportunity to devote more resources to their growth, rather than to the expansion of government. This can be manifested, in part, by reform of the tax code's small business capital expensing provisions.

THE CASE FOR INCREASING SMALL BUSINESS CAPITAL ASSET EXPENSING

The tax implications underlying small business owners' purchasing decisions affect the timing of those decisions, as well as whether or not to proceed. Small business owners are keenly aware of the impact of the U.S. tax code on their decisions. Currently, the recovery of investment in capital expenditures by the small business sector is limited by antiquated depreciation rules and anemic allowances under Internal Revenue Code section 179.

In July 2000, the Treasury Department issued its "Report to The Congress on Depreciation Recovery Periods and Methods" in response to Congressional concerns about the appropriateness of current depreciation rules. Congress feared that the rules might measure income improperly, thereby creating competitive disadvantages and an inefficient allocation of investment capital, and requested a study to determine if improvements could be made.

Although the 132-page document presented some analysis of the issue, Treasury concluded that – in Treasury Tax Legislative Counsel Joseph Mikrut's words – "Resolution of the issue of how well the current recovery periods and methods reflect useful lives and economic depreciation rates would involve detailed empirical studies and years of analysis. The data required for this analysis would be costly and difficult to obtain. Thus, the Report does not contain legislative recommendations concerning specific recovery periods or depreciation methods." (Treasury Tax Legislative Counsel Joseph Mikrut's testimony before the House Ways and Means Subcommittee on Oversight, September 26, 2000.)

The Report, however, correctly noted that the current depreciation system is dated; is not indexed for inflation; and does not provide for updating depreciation rules to reflect new assets, new activities, and new production technologies.

Under Internal Revenue Code section 179, businesses can annually expense up to $25,000 of purchased capital assets placed into service during a tax year. This amount, however, is subject to phase-out, dollar for dollar, when the cost of qualifying property placed into service that year exceeds $200,000. While this allowance has been increased very modestly in recent years, it is not scheduled to increase any further under current law.

In general, businesses investing more than the annual expensing allowance must recover the cost of their expenditures over several years through the depreciation system. Inflation, however, erodes the present value of future depreciation deductions. The fact that section 179 contains no mechanism increasing this allowance or the phase-out levels for the effects of inflation further exacerbates this problem.

This injustice would best be remedied through the full expensing of business equipment. At the very least, amendment of section 179 to allow progressively greater expensing amounts, and enhanced phase-outs, would be warranted. Such measures would spur additional investment in business assets and lead to increased productivity, creation of more jobs, and economic growth. Moreover, it would be a component of good, long-term public policy.

Current proposals, such as the one embodied in the President's Jobs and Growth Plan, would go a long way toward enabling and enticing the nation's small businesses to increase their investments in productivity-enhancing business property. The President's section 179 expensing proposal would both triple the maximum deduction and introduce enhanced phase-out levels, stemming the erosion in the value of depreciation deductions that would otherwise occur over time. This, in turn, would further augment current cash flow and encourage and enable these companies to invest in new machinery and equipment, increasing their productivity and providing a further boost to the economic sectors that produce and service those items. In sum, these funds would be used to grow businesses, boosting the nation's economic growth and creating new jobs.

CONCLUSION

At various times, disagreements have arisen over how much small business asset expensing should be increased. However, the U.S. Chamber recognizes that most members of both major political parties support reform of section 179 and augmented expensing, and are ready to do something about it.

Many realize that liberalization of the expensing provisions would, in many cases, be the swing factor that would provide the impetus for small businesses to go out there and make that new, additional capital investment. All that remains is to decide on the parameters of reform, craft the legislative language, and enact it.

It's time to iron out those details and get it done.

Testimony of

Dena J. Battle

National Federation of Independent Business

Before the
House Small Business Subcommittee on Tax, Finance and Exports

April 3, 2003

Good morning, Mr. Chairman and distinguished members of this Committee.

My name is Dena Battle and I am testifying on behalf of the 600,000 members of the nation's largest small-business group, the National Federation of Independent Business (NFIB).

NFIB's membership spans all 50 states and the District of Columbia. Mirroring the nation, our membership breakdown is focused primarily on the service and retail sectors. Our members vary in size and number of employees; they are shopkeepers, manufacturers, small entrepreneurs, suppliers, and owners of neighborhood businesses where you and your constituents may shop, or send dry-cleaning, or get haircuts, or buy flowers.

On their behalf, I appreciate the opportunity to discuss the importance of Section 179 expensing legislation and the impact it will have on small businesses.

Today's uncertain economic times are especially tough on our small business owners. They tend to experience economic ripples harder and faster than anyone else. Thus, small businesses tend to be an early warning system for our economy's health.

Each month NFIB tries to assess the state of our small business members by conducting a survey and incorporating it into a report, the Small Business Economic Trends or SBET. The most recent SBET revealed that sales for small businesses have continued to decline, reaching one of the lowest levels registered in the past two years. In addition, our Small Business Optimism Index fell 3.1 points in February - another alarming plunge. Most small business owners clearly are not optimistic that the economy is recovering.

The President's tax proposal to increase the Section 179 expensing limits would make a dramatic difference for small business - saving them needed tax money,

encouraging investment and simplifying tax filings. Under current law, small businesses can expense up to $25,000 this year as long as the total investment is less than $200,000. Both of these figures are far too low. The President's plan and Congressman Herger's legislation, H.R. 179, would increase Section 179 expensing limits to $75,000 and increase the total investment limit to $325,000. More importantly, in addition to the increased limits, both of those figures would be indexed for inflation - so Congress will not have to come back and revisit this provision every few years.

Allowing small business owners to expense critical investments is a key component of an expanding economy, since this money will be used immediately to grow businesses and create new jobs. Under current law, the majority of NFIB members' growth is limited because they exceed the small-business expensing limit in the first three months of the year. According to NFIB's Small Business Economic Trends Report, about one in ten small business owners have made an investment of $100,000 or more in the prior six months. Even more respondents reported that they invested between $10,000 and $99,000 during the last six months.

In sum, if this expensing exemption is increased, well over one million small businesses would be able to purchase equipment and grow their business – and that will result in overall economic growth.

But this issue is more about people than numbers. Carolyn Galvin owner of Storeel Corporation says that she's going to quadruple the investments that her company will make this year as a result of allowing more expensing. She plans to upgrade her PCs, buy new table-saws, and possibly purchase a new forklift. Another NFIB member told me that the increases in Section 179 limits would allow him to hire three new employees.

Another crucial element in the President's proposal for section 179 is the increase in the investment limit. The current investment limit of $200,000 penalizes small-business owners for making substantial business investments. There are business owners who have made the choice not to expand beyond that $200,000 level because they don't want to lose the benefit of expensing. Increasing the investment limit to $325,000, as proposed, will encourage business owners to make decisions based on business considerations rather than tax considerations. Under current law, owners might choose to string projects out over two or three years rather than conduct them in a single year. Now they won't have to make that choice; they'll be able to purchase the equipment they need immediately.

In addition to the economic benefits of Section 179, there is also a simplification issue. Section 179 eliminates the practice of depreciation, which is one of the most complicated sections of the Internal Revenue Code. The process of depreciation transforms a very simple business expense in theory into a horribly

complex record-keeping and accounting procedure in practice. To give you a better idea, most tax forms have an estimate of the time it will take to fill out. It's usually printed on the front page. I called the IRS to find out why there was no time estimate for the depreciation form, and they told me that they could never figure out how long it would take.

Does this problem affect many small businesses? Yes! The Depreciation and Amoritization form (Form 4562) is the most commonly filed secondary business tax form. Seventy- three percent of C-corporations filed one in 1995 and sixty-nine percent of S-Corporations filed one.

The tax code, with all of its complexities, takes time away from a business owner's focus on running and expanding his or her business. Doing away with depreciation and allowing businesses to expense means more time to focus on what's important - running their business - not filling out tax forms.

These businesses are major job creators in local economies and also contribute dramatically to local tax bases. In fact, according to recent Bureau of Labor Statistics projections, small-firm-dominated sectors of the economy have or will contribute more than 60% of the new jobs from 1994 to 2005.

Small business owners have survived and served as this nation's job growth engine, despite the economic challenges that they have faced over the last two years. By lifting this burden we will help them to reach their full potential and be able to see the true power of the American entrepreneurial spirit.

Thank you, Mr. Chairman, for your leadership on this issue and for holding this important hearing.

Subcommittee on Tax, Finance, and Exports Hearing
10 a.m. in 2360 Rayburn HOB

Hearing on Small Business Expensing, Section 179 of the IRS Code

Associated Builders and Contractors (ABC) appreciates the opportunity to submit the following statement for the official record. We thank Chairman Pat Toomey (R-PA), Ranking Member Millender-McDonald (D-CA) and members of the Small Business Subcommittee on Tax, Finance, and Exports for addressing the issue of Small Business Expensing.

ABC is a national trade association representing over 23,000 contractors, subcontractors, material suppliers, and construction-related firms from across the country and from all specialties in the construction industry with a network of 82 state chapters. Our diverse membership is bound by a shared commitment to the merit shop philosophy of awarding construction contracts to the lowest responsible bidder, regardless of labor affiliation, through open and competitive bidding. With more than 80 percent of construction today performed by open shop contractors, ABC is proud to be their voice.

The construction industry, which represents almost 12 percent of the Gross National Product and nearly 9 percent of the Gross Domestic Product, is an industry of small businesses as 94% of all construction companies are privately held and 1.3 million construction companies are not incorporated. With almost 7 million workers employed in the industry, construction continues to create new and beneficial jobs each year. For every $1 million spent in construction, $3 million in economic activity is generated and 13 new permanent jobs are created.

When considering viable ways to stimulate the economy and spur job creation, an increase in expensing limits is one remedy that works. The construction industry, which according to the Bureau of Labor Statistics (BLS) needs 250,000 new craft professionals to replace an aging and retiring workforce, will benefit greatly from any increase in the amount of new equipment that they can immediately expense. Not only will it provide many construction businesses the opportunity to invest in costly, new equipment, but it will also create an incentive to hire more workers.

ABC applauds the subcommittee for addressing this issue, which is included in the President's growth and jobs package. Specifically, the plan increases the amount of investment that may be immediately deducted by small businesses from $25,000 to $75,000, beginning in 2003. The amount of investment qualifying for this immediate deduction begins to phase out for small businesses with investment in excess of $325,000, a figure increased from $200,000. Both parameters are indexed for inflation beginning in 2004. In effect, all businesses could then expense more of the cost of new machinery and equipment, thus providing capital for further job creation. This will allow small firms to expense additional investments, therefore enabling those businesses to expand and create new jobs. This will lower the cost of capital for tangible property and

eliminate depreciation record-keeping requirements. This change will also increase small business owners' ability to compete in today's technology-dependent markets.

The enactment of the 30 percent bonus depreciation allowance passed in March 2002, stopped and partially reversed a two-year decline in capital spending that was one of the worst in history. While capital spending did not immediately return to its pre-recession peak, it did rebound and has remained above the pre-March low -- a success given the magnitude of the recession. Capital spending is still helped by the 30-percent expensing allowance and capital spending will be further helped by the President's proposal to treble the first-year expensing allowance for the nation's smallest businesses. But much more needs to be done. Capital spending must start growing at even higher rates if the economy is to return to its pre-recession levels anytime soon.

The current tax code requires businesses to depreciate their investment outlays over a period of time instead of deducting the entire cost at once. However, a business must buy an entire machine or building all at once, thus tying up funds that otherwise would be available to earn income. New equipment, particularly in the construction industry, is extremely expensive. Therefore, there has been a decline in capital investment which has resulted in slower income growth, less employment, and a lower standard of living for many Americans.

An increase in expensing limits provides two primary benefits: it reduces the high cost of the newest capital equipment and provides up-front additional cash flow to help finance the purchase. Currently, many small businesses, construction firms included, must choose between offering incentives to employees such as pay increases, bonuses, or additional benefits - or investing in new equipment. With an increased first year expensing limit, they can do both – thus further stimulating the economy.

Small businesses particularly benefit from expensing provisions. Since depreciation rules raise the cost of capital, small businesses are most affected given constraints on raising the capital to invest in new technologies. By increasing the amount that can be deducted, small businesses will be able to purchase more equipment which increases the productivity of the company. It is productivity increases that will increase employment, raise the wages of workers, lower prices for consumers, and thus, raise the standard of living for all Americans.

In conclusion, ABC strongly supports Section 179 of the IRS Code for increased small business expensing. The effect of new capital investment by all businesses, including the construction industry, will result in quicker economic recovery.

ABC appreciates the opportunity to submit comments on this vital issue. We look forward to continuing a constructive dialogue on how to provide small business the means and incentives to positively contribute to our nation's economy.

STATEMENT FOR THE RECORD

Thomas M. Sullivan

Chief Counsel for Advocacy

United States Small Business Administration

The President's Proposal to Increase Small Business Expensing

Subcommittee on Tax, Finance and Exports

Committee on Small Business

United States House of Representatives

Thursday, April 3, 2003

Chairman Toomey and Members of the Subcommittee:

Thank you for this opportunity to submit comments for the record. My name is Thomas Sullivan and I am the Chief Counsel for Advocacy at the Small Business Administration (SBA). Congress established the Office of Advocacy to represent the views of small entities before Federal agencies and Congress. The Office of Advocacy is an independent entity so the views expressed in this statement do not necessarily reflect the views of the SBA or the Administration.

I commend you and the Subcommittee for your leadership in holding a hearing to underscore the importance of the President's efforts to expand section 179 of the Internal Revenue Code providing for small business expensing. As your hearing disclosed, this effort has the strong support of the small business community. The President's proposal would increase the amount of qualifying property that a taxpayer can elect to expense during the tax year from $25,000 to $75,000 and would be very beneficial to small businesses. In addition, the threshold limit for phasing out the election is raised to $325,000 thereby making the benefits of the provision available to a larger group of small businesses.

Expanding section 179 specifically helps small business by dramatically reducing the paperwork required to account for the capitalization of the purchased property. A study performed by my office showed that, under current law, small businesses spend almost twice as much per dollar of sales on tax compliance as their large competitors.[1] Anything Congress can do to simplify tax recordkeeping will help small businesses cut costs and be more competitive.

This proposal also improves small businesses' ability to retain and accumulate capital for growth. It reduces the cost of capital for purchases by a significant amount. Cost of capital is another area where small businesses have a built-in disadvantage relative to large businesses.

The hearing showed that trade associations are strong supporters of the President's proposal. Small business groups with which we work strongly support the increased expensing, particularly

[1] See *The Impact of Regulatory Costs on Small Firms,* Office of Advocacy, Crain and Hopkins, 2001, where the cost of tax related regulatory compliance per employee was found to be more than twice as expensive for small businesses (firms with fewer than twenty employees) than large businesses (firms with over 500 employees).

the delegates to the White House Conference on Small Business. Increased expensing was one of the top recommendations made by the 2,000 delegates to the Conference representing the 25,000 small business owners who participated nationwide.[2]

The President has made jobs the centerpiece for his economic plan. Advocacy studies have shown that small businesses lead the Nation out of recessions and create 60 to 80 percent of net new jobs in any given year.[3] The President's expensing proposal can help small businesses spur the economy by stimulating purchases and increasing productivity.

The Office of Advocacy is ready to work with you and other Members of Congress to support enactment of this proposal and additional measures that benefit small businesses. The President's proposal gives small businesses the kind of simple, straightforward assistance necessary to help them take the initiative to invest in their future.

Thank you for your efforts on behalf of small businesses. Please feel free to call on me if I can be of assistance to you or the Subcommittee.

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[2] *Foundation for a New Century - Report on the Implementation of the Recommendations of the 1995 White House Conference on Small Business;* Office of Advocacy, U.S. Small Business Administration; 1995, p. 48.
[3] Office of Advocacy, U.S. Small Business Administration, from data provided by the U.S. Bureau of Census. The figure is based on net new jobs for businesses with fewer than 500 employees for the last decade. See http://www.sba.gov/advo/stats/sbfaq.pdf

SMALL BUSINESS
LEGISLATIVE
COUNCIL

**SMALL BUSINESS LEGISLATIVE COUNCIL'S
STATEMENT FOR THE RECORD
HOUSE SMALL BUSINESS COMMITTEE
SUBCOMMITTEE ON FINANCE AND EXPORT
ON SECTION 179 OF THE INTERNAL REVENUE CODE
APRIL 3, 2003**

Section 179 of the Internal Revenue Code allows small business to expense (fully deduct from taxable income) a limited amount of the cost of new business equipment in a year. This is known as "direct expensing." Under current law, businesses can expense up to $25,000 a year for taxable years 2003 and beyond. This tax benefit is limited by a provision of the law, which stipulates that the expensing amount is phased out dollar for dollar for any amount of investment above $200,000 in a given year. Under the current law, since the expensing caps have not been indexed and therefore their value has decreased over time, many small businesses are unable to take full advantage of Section 179.

Proposed legislation by Congressman Wally Herger (H.R. 179) and Senator Olympia Snowe (S. 158) would solve this problem by increasing the expensing limit to $75,000 and the phase out to $325,000. Furthermore, the President has also included the same increases in Section 179 in his economic growth package. The Small Business Legislative Council (SBLC) strongly endorses the Herger and Snowe bills, as well as, the President's proposal to increase the Section 179 limits.

Increasing the expensing limit to $75,000 is also one of the best ways Congress can stimulate economic growth. Increasing the Section 179 expensing limits will encourage businesses to invest in new equipment and machinery. Hundreds of thousands of

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American small businesses make machinery, provide necessary services or parts or support sales and distribution, they will benefit from increased direct expensing.

Recently, there has been some negative press coverage regarding Section 179 and the expensing of large Sports Utility Vehicles (SUVs) that weigh over 6,000 pounds. These inaccurate articles depicted small business owners as abusing the expensing provisions for personal use.

It is important to note that there already is a provision in the law that requires the vehicle to truly be used for business purposes. This provision has worked well in preventing abuse. Unless the vehicle is used primarily for business purposes it is not eligible for expensing. Also the actual number of vehicles that meet the weight threshold are far fewer in number than commonly believed. Weight definitions are not interchangeable.

As Congress continues onward with the economic growth debate, SBLC expects the SUV stories to resurface. SBLC encourages this Committee to take immediate action to dispel any misinformation about Section 179 and SUV expensing.

The Small Business Legislative Council is a permanent, independent coalition of 70 trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. Our policies are developed through a consensus among our membership. Individual associations may express their own views.

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